Canada. Royal commission
taxation.
Press releases.
[1967?]
[1966]

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Gov't Pubns
Dec. '67

ROYAL COMMISSION ON TAXATION

PRESS RELEASES

The Commission has submitted a lengthy, complex Report in six volumes. These volumes contain literally hundreds of conclusions and recommendations which, if implemented, would make fundamental changes in Canadian taxation concepts, principles and practices.

In every instance the Commission has endeavoured to express its proposals clearly and in logical sequence. The Report includes many illustrations of how these proposals would affect taxpayers in various circumstances. Technical terms have been avoided wherever possible. The Introduction in Volume 1 discusses the highlights of the Report. Each chapter ends with a Summary of Conclusions and Recommendations. Each Volume contains both a Table of Contents and, except for Volume 1, an Index. A Consolidated Index for Volumes 2 through 6 is available as an unnumbered volume.

Since virtually every aspect of Canada's present and proposed tax systems have been dealt with in detail in this Report, obviously even the large number of attached press releases can hope to cover only the major recommendations and discuss only briefly the underlying factors. The press releases are offered in the hope that they will prove useful to those in need of an immediate condensation, on the understanding that this necessarily omits many important points in the Report itself.

Throughout these press releases—as in the Report itself—the tax changes announced in the supplementary budget of Dec. 19, 1966, are not taken into account.

The press releases are numbered as follows:

1. Main Proposals
2. Sales Taxes
3. Integration
4. Capital Gains
5. Employment Income
6. Gifts and Bequests
7. Medical Expenses
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9. Deferred Income
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22. Co-Operatives and Other Mutual Organizations
23. Farming, Fishing, Forestry, Construction
24. Stabilization Policies
25. Revenue Drag
26. Economic Effects
27. Foreign Investment
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30. Minority Report - Commissioner Grant
31. Minority Report - Commissioner Beauvais

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 1

MAIN PROPOSALS

OTTAWA — A complete transformation of the Canadian tax system designed mainly to achieve equity—taxation according to the ability to pay—has been recommended by the Royal Commission on Taxation.

The proposed new system would mean tax reductions for most low income and middle income families, increased Canadian investment in Canadian enterprises without discriminating against foreign investors, and greater economic efficiency—all this without reducing federal tax revenues.

Hundreds of conclusions and recommendations are included in the massive six-volume, 2,600-page Report of the Commission, headed by Kenneth LeM. Carter of Toronto. The Report is the result of four and one half years of work by the six-member Commission, aided by a research staff that at one time numbered 150 lawyers, accountants and economists.

Following are the Commission's major proposals in brief:

—The ability-to-pay principle would be reflected in a new "comprehensive tax base" that would include, for tax purposes, all net gains in purchasing power, including capital gains and windfalls and many other forms of real income that now are tax-exempt.

—Taxation of capital gains would not be retroactive. Only those increases in the market value of assets that take place after the adoption of the proposed new system would be subject to tax if realized. There would be a $25,000 lifetime exemption on gains realized on the sale or disposition of owner-occupied homes and farms. Capital losses could be deducted from any income.

—Rates of personal income tax would be greatly reduced. Instead

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of today's easily avoided 80 per cent the top rate would be 50 per cent. However, as many persons have substantial income which now is untaxed, they would pay higher taxes despite the lower rates. But those who rely mainly on wages and salaries would pay less. A number of existing deductions would be replaced by tax credits, more valuable for low income families. All told, an estimated 46 per cent of tne country's 7,000,000 taxpayers would get income tax cuts of more that 15 per cent under the new system.

—New tax-paying units would be created and a different rate schedule would apply to each—families (parents and children under 21, or under 25 if they are taking post-secondary education) and individuals. Families would be required to pay tax on their aggregate income. Transactions within the family would not be taxed; for example, there would be no tax on a man's estate when it passed to his wife or dependent children.

—The existing 11 per cent federal sales tax applied at the manufacturing level would be moved to the retail level, at a reduced rate of 7 per cent. The tax would be extended to certain services. Food, shelter and production goods, as well as exports, would continue to be exempt. Prescription drugs would also become exempt. The special excise taxes on some so-called luxury goods would be eliminated. The net result would be an average drop of about 10 per cent in federal sales tax paid by families with incomes below $10,000.

—There would be a major cnange in the way corporation income is taxed. Tax would still be <u>collected</u> from corporations, but at a single flat rate of 50 per cent; the present lower rate of 21 per cent on the first $35,000 of corporation income would be abolished, with its investment-incentive element replaced by rapid-depreciation privileges for new and small businesses.

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—But corporate and personal income taxes would be "integrated", that is, every Canadian shareholder of a Canadian corporation would be granted a 100 per cent credit for taxes paid on his behalf by the corporation. Although this major new benefit would be partly offset by the full taxation of share gains, it would increase the flow of Canadian savings—both individual and institutional—into Canadian equities.

—While realized share gains would be taxed at full rates, for most corporations the taxable gain would only be part of the total gain in the price of their shares. Because of integration, share gains for tax purposes would include only the gains in excess of those resulting from the retention of earnings by corporations.

—Co-operatives and credit unions would be treated in such a way that they would have neither tax advantages nor disadvantages relative to other forms of business organization.

—Inefficient concessions to industry would be abolished. This would mean the end of the present three-year income tax exemption for new mines, and of depletion allowances now granted to both the mining and petroleum industries. While the smaller companies would be little affected, the taxes collected from a few large companies would increase sharply.

—Major changes in the tax treatment of various kinds of contractual saving would make Registered Retirement Income Plans more attractive. Tax collections from life insurance companies would be substantially increased as a result of taxing them like other businesses.

—Gifts other than those between members of a family unit would be included in the comprehensive base and would be taxed like other income. But there would be substantial annual and lifetime exemptions on such gifts.

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Gift and death taxes as such would be abolished.

—An employee's expenses in earning his income would be recognized for tax purposes, just as business expenses are. He would be able to claim actual expenses (but not those for commuting), or could claim an optional standard deduction of 3 per cent of his income up to a limit of $500. Special tax credits would be given to working mothers.

—Tough, arbitrary limits would be placed on travelling and entertainment costs to stop "expense account living". Any businessman who overspent these specified daily limits would be forced to take the excess into his own personal income, and pay tax on them.

—Many of these proposals, especially those changing the tax base, would have profound implications for federal-provincial fiscal relations. The Commission said Ottawa should not make any further abatements of personal income tax to the provinces, and should take over the entire job of taxing the income of corporations. Provinces which now have sales taxes—all except Alberta—would be encouraged to adopt the proposed federal sales tax base, and collect all sales taxes. Any further "tax room" provided by the federal government to the provinces would be through reducing the federal sales tax rate.

—Federal tax collection and administration would be moved out of the Department of National Revenue and into a new, independent, non-political Board of Revenue Commissioners, which would report fully to the public on its operations. Commissions rather than government departments are used to collect taxes in both the United States and Britain. A new Tax Court would be established, replacing the existing Tax Appeal Board.

The tax system recommended by the Commission would raise about

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the same revenues as the existing system during the transitional period. After that period it would raise more than the present system. Thus after four or five years tax rates could be furtner reduced.

Detailed estimates were made by the Commission of the revenue the proposed system would have raised in 1964, had there been no transitional costs. These changes in brief: (in millions of dollars)

Corporation income tax	532
Personal income tax	-42
Gift and estate taxes	-143
Sales tax	-125
Total change	222

Because of the proposed integration of personal and corporation taxes and the move from gift and estate taxes to the taxation of gifts as income, these estimates must be interpreted carefully.

A large proportion of the increase in corporation tax collections would be borne by non-residents and would result from the withdrawal of both the dual rate of corporation tax and special industry concessions. The increase in corporation tax attributable to residents would be more than offset by the refunds of corporation tax to resident shareholders. Despite the full taxation of share gains, the weight of tax on corporate source income would be reduced for resident shareholders as a group.

Taxing gifts as income would result in more revenue being raised despite the abolition of gift and estate taxes as such.

The proposed new tax system also would have tne effect of redistributing income in favour of those with low incomes. At present, the Commission said, some low income families are overtaxed because they

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do not benefit as much from government expenditures as other families with the same income. And some upper income families are not contributing enough through taxes to this income redistribution.

"We are firmly convinced that this redistribution is necessary if we are to achieve greater equality of opportunity for all Canadians and make it possible for those with little economic power to attain a decent standard of living," the Commission said.

"However, we are also convinced that the rates of tax which are applicable at any level of income should not be so high as to discourage initiative and thereby reduce the production of goods and services for Canadians."

The following table shows the number of taxpayers in each income class who would experience increases, decreases, and no changes in direct taxes (all personal and corporation income taxes and gift and estate taxes) if the Commission's recommendations were implemented:

Comprehensive Income	Decreased by more than 15 per cent	Changed by less than 15 per cent	Increased by more than 15 per cent
Less than $5,000	2,713,328	1,685,259	370,048
$ 5,000 - $ 9,999	404,144	1,038,796	173,338
10,000 - 14,999	5,269	125,901	37,960
15,000 - 24,999	1,895	70,918	23,885
25,000 or over	182	42,263	26,259
Total	3,124,818	2,963,137	631,490

The Commission was appointed in 1962 to make the widest possible inquiry into the Canadian tax system. Cost of the inquiry will be close to $3,500,000.

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Although the Commission looked into every aspect of federal taxes, except tariffs, it did not deal directly with provincial or municipal taxation, except to reject proposals that home-owners be given credit for property taxes in computing federal income taxes.

Said the Commission:

"We hope Canadians will accept the challenge implicit in our recommendations. And there can be no doubt that our recommendations constitute a great challenge. Preconceived opinions about taxation are deeply and firmly held. Many will find it extremely difficult to take a new look at old questions. Because some facts cannot be readily ascertained, honest differences of opinion are inevitable. There is a danger that the debate about these minor factual questions will divert attention from the major issues.

"In the same way great damage could be done by the espousal of all the popular measures recommended and rejection of others—without appreciating that the politically attractive changes are only feasible as part of an integrated programme. These and many other hurdles have to be overcome if Canada is going to obtain the best possible tax system."

Chairman of the six-member Commission was Kenneth LeMesurier Carter, 60, of Toronto, a chartered accountant, a former Chairman of the Board of Governors of the Canadian Tax Foundation, and at the time of his appointment President of the Canadian Welfare Council.

Other Commissioners: J. Harvey Perry, York Mills, Ontario, former Director of the Canadian Tax Foundation, now Executive Director of the Canadian Bankers Association; A. Emile Beauvais, Quebec City, a Doctor in Financial Science at Laval University, and a past Governor of the Tax

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Foundation; Donald G. Grant, Halifax, a lawyer, President of the Nova Scotia Trust Company and director of several large Maritime firms; Mrs. Eleanor Milne, Winnipeg, active in the financial management of several organizations; and Charles E. S. Walls, Victoria, a farmer, Manager of the British Columbia Federation of Agriculture.

All members of the Commission signed the main Report. However, both Mr. Beauvais and Mr. Grant submitted minority reports, taking issue with several of the major and minor recommendations, particularly the taxation of all capital gains at progressive rates.

The Commission levelled these criticisms against Canada's existing tax system:

1. It does not afford fair treatment for all Canadians. People in essentially similar circumstances do not pay the same taxes. People in essentially different circumstances do not bear appropriately different tax burdens.

2. Canadians are less well off than they could be because there are fewer goods and services available than could be achieved with the more efficient use of labour, capital and natural resources. The present tax system has contributed to this situation.

3. Compliance and collection costs have been needlessly raised by duplication in federal and provincial administrations. Federal tax administration is not sufficiently shielded from political influence, and is too centralized for efficiency and convenience. Federal administrative and judicial appeal procedures are deficient.

4. The fiscal system has not been used as effectively as it could have been used to maintain full employment, contain inflation, and

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encourage Canadian ownership and control of Canadian industry.

5. Federal procedures used to obtain and analyze new ideas prior to the introduction of new tax legislation are inadequate—as are the procedures for hearing the views of taxpayers on proposed legislation.

"We are fully aware that these conclusions constitute a severe criticism of the present tax system," the Commissioners said. "They were not arrived at lightly nor are they the inevitable result of preconceived opinions. Our bias when we began our task was that the present system was basically sound and compared favourably with the systems of other countries.

"While we are still of the opinion that the present Canadian tax system is as good as most other systems, we are convinced that it falls far short of the attainable objectives.

"We therefore recommend many fundamental changes which, if adopted, would produce a complete transformation and, we believe, result in greater equity and efficiency."

In designing the new tax system, the Commission sought to achieve several objectives—equity, protection of individual rights and liberties, economic growth and stability, the strengthening of Confederation. But some of these goals conflicted when specific proposals were being considered.

Whenever such conflicts arose that could not be compensated for by making adjustments in other features of the proposed system, or by recommending changes in other government policies, they were reconciled in favour of equity.

"We are convinced that preserving and developing the system by scrupulously fair taxes must override all other objectives," the Commission said.

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At the same time, the Commission is convinced that the tax system proposed is both administratively workable and would increase the future output of the Canadian economy.

The Commission believes that taxes, to be equitable, should be allocated according to the ability to pay. This requires that individuals and families pay taxes that are proportionate to their discretionary economic power. And this in turn is defined as the power to command goods and services for personal use after meeting personal and family obligations and responsibilities.

Determining the relative discretionary economic power of individuals and families is partly a matter of judgment. The Commission has embodied these judgments in the proposed schedules of progressive tax rates, and in the concessionary tax credits and deductions provided to tax units with different family characteristics.

But to avoid capricious results, these rates and concessionary provisions must be applied to a tax base that measures the changes in each tax unit's total economic power.

This is the principle underlying the new comprehensive tax base. It simply measures all "income". But under the new tax system, income would be a much broader concept than "income" at present.

Said the Commission:

"If a man obtains increased command over goods and services for his personal satisfaction we do not believe it matters, from the point of view of taxation, whether he earned it through working, gained it through operating a business, received it because he held property, made it by selling property or was given it by a relative.

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"Nor do we believe it matters whether the increased command over goods and services was in cash or in kind. Nor do we believe it matters whether the increase in economic power was expected or unexpected, whether it was a unique or recurrent event, whether the man suffered to get the increase in economic power or it fell into his lap without effort.

"All of these considerations should be ignored either because they are impossible to determine objectively in practice or because they are irrelevant in principle, or both.

"By adopting a base that measures changes in the power, whether exercised or not, to consume goods and services we obtain certainty, consistency and equity."

Taxing different kinds of gains differently opens many loopholes. It places great pressure on the development of tax minimization schemes. It also distorts the economy, for people are encouraged to do things that produce gains that are lightly taxed, and to avoid activities that result in gains that are heavily taxed. The shunned activities are often more productive.

The attempt to distinguish between "income" gains and "capital" gains has also meant a great deal of uncertainty. No clear line of demarcation is possible.

The Commission's terms of reference required it to devise a tax system that would raise "sufficient" revenue—that is, about the same revenue as the present system. The Commission emphasized that if marginal rates are to be reduced, the tax base must be broadened, inefficient concessions must be replaced by equally effective concessions that have a lower revenue cost, and unnecessary concessions must be withdrawn.

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The adoption of the comprehensive tax base can be looked upon as part of the price paid for a general reduction in tax rates.

Most employees already are taxed on a base that is even broader than the comprehensive tax base as the Commission would define it. For them, the proposal would involve no great changes. The tax base for most of those who depend primarily on other kinds of income would be greatly broadened.

The most contentious addition to the tax base would be realized capital gains. Under the Commission's proposals, there would be a lifetime exemption of $25,000 on gains realized from the sale of houses and farms. Property gains would be deemed to have been realized on leaving Canada, or on death (unless the property passed to a surviving spouse or dependent child).

"A dollar gained through the sale of a share, bond, or piece of real estate bestows exactly the same economic power as a dollar gained through employment or operating a business," said the Commission. "The equity principles we hold dictate that both should be taxed in exactly the same way. To tax the gain on the disposal of property more lightly than other kinds of gains or not at all would be grossly unfair.

"These radical reforms are advocated because equity can be achieved in no other way, because in our opinion there would be no adverse economic effects through their adoption when combined with our other proposed changes, and because they would simplify the tax system and reduce uncertainty.

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"If the full taxation of property gains would result in dire economic circumstances or hopelessly complex administrative questions, some backing away from equity principles could be justified. We are satisfied that neither justification holds."

The Commission said it must be recognized that taxation of capital gains would be only one part of a new system that would have greatly reduced marginal personal rates of tax, liberal new income-averaging provisions to soften the tax impact of income fluctuations, full credit to resident shareholders for Canadian corporation taxes, more efficient incentives for new and small business, loss provisions to remove any tax bias against risk-taking, and an increased tax concession to retirement savings.

"As one component of a package with these features, we can dismiss the claims that to tax capital gains would destroy initiative, reduce saving, and drive people out of the country."

But in addition, many other receipts—some now exempt from tax—would be added to the tax base. Included would be family allowances, non-cash benefits provided by employers (such as the full market value of free or low cost meals or lodging), patronage dividends by consumer co-operatives, interest rebates from credit unions, life insurance policy dividends and the property income earned each year on policy reserves.

Also included in the new tax base would be all benefits paid under "income insurance" plans—including unemployment insurance, supplementary unemployment insurance, workmen's compensation, sickness and

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accident insurance and group life insurance. But contributions of both employees and employers would be deductible in computing their incomes.

(In recommending that government transfer payments such as unemployment insurance and workmen's compensation be taxed as income, the Commission emphasized that it is not prejudging the adequacy of these payments. It recommends that governments review the size of the benefits if they are brought into the tax base. The point is not that they are too big or too small, but that by failing to tax them some beneficiaries under these plans now are paying less tax than others with the same economic power. Exemptions and deductions from income provide no benefit to those who have no taxable income. The only way to help these people—the people who most need the help—is to increase government transfer payments.)

Gambling gains also would be added to taxable income. The Commission said gambling losses should be deductible against gambling gains but not against other income. Such gains are not now taxed unless the taxpayer makes a business of gambling.

Strike pay also would be taxed; the Commission regards it as an addition to income under an informal income-maintenance scheme. Union dues, of course, would still be deductible for tax purposes.

The estate and gift taxes would be abolished. But gifts and inheritances would be taxed to the recipient—as part of income—if they came from outside the family tax unit. Thus there would no longer be any tax on bequests to a widow from her husband. Each person would have a $5,000 lifetime exemption on such gifts and bequests, and in addition there would be annual exemptions of $250 for each individual, $500 for each

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married couple and $100 for each dependent child. In effect, most people would never pay tax on any gifts.

Having adopted the principle of taxing net gains in discretionary economic power, the Commission then tackled the problem of how to make allowance for non-discretionary spending—the outlays required to meet personal and family responsibilities.

Under the present tax system this is accomplished to a certain degree through exemptions—the $1,000 exemption for everyone, the $1,000 additional exemption for a wife whose income does not exceed a certain amount, and the $300 exemption for each child qualified to receive family allowances.

This arrangement would be substantially modified under the Commission's proposals. Replacing it would be a personal income tax rate schedule for individuals and another schedule for family income. In both cases the first-income bracket would be taxed at a zero rate. The zero-rate bracket would be $1,000 for individuals and $2,100 for families. These zero-rate brackets would have exactly the same effect as exemptions.

In addition, the costs of raising children—costs which usually are higher for the first than for subsequent children—would be recognized through tax credits. These would amount to $100 for the first child, and $60 for each additional child. For low and middle income families, the proposed tax credits would be more valuable than the present exemptions.

If both husband and wife were at work for more than 120 days a year, and if they had one or more children, they would be allowed to reduce their income taxes otherwise payable by $80. They would get an additional tax credit of $120 a year if their family included a child under 7 years

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old—to recognize the additional costs incurred by working mothers of pre-school youngsters.

Following are the separate rate schedules recommended by the Commission:

RECOMMENDED RATE SCHEDULES

Taxable Income	Unattached Individuals: Tax at Bottom of Bracket	Unattached Individuals: Marginal Tax Rate on Income In Bracket	Family Units: Tax at Bottom of Bracket	Family Units: Marginal Tax Rate on Income In Bracket
	$	%	$	%
Less than $ 1,000	None	—	None	—
$ 1,000 - 1,500	None	12	None	—
1,500 - 2,000	60	15	None	—
2,000 - 2,100	135	17	None	—
2,100 - 3,000	152	17	None	13
3,000 - 4,000	305	20	117	16
4,000 - 5,000	505	22	277	18
5,000 - 6,000	725	23	457	19
6,000 - 8,000	955	24	647	20
8,000 - 10,000	1,435	26	1,047	21
10,000 - 12,000	1,955	28	1,467	22
12,000 - 15,000	2,515	30	1,907	24
15,000 - 20,000	3,415	32	2,627	27
20,000 - 25,000	5,015	35	3,977	31
25,000 - 30,000	6,765	37	5,527	35
30,000 - 40,000	8,615	39	7,277	38
40,000 - 50,000	12,515	42	11,077	42
50,000 - 60,000	16,715	44	15,277	44
60,000 - 80,000	21,115	46	19,677	46
80,000 - 100,000	30,315	49	28,877	49
Over 100,000	40,115	50	38,677	50

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The way in which people would be affected by these changes would vary widely according to their individual circumstances.

Obviously, however, if a person's taxable income was not increased by switching to the comprehensive tax base, the lower rates would mean lower taxes. This in fact would be the case for almost all individuals and families whose income is strictly from wages and salaries.

Changes for this group are shown in the following table.

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CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM FOR AN UNATTACHED INDIVIDUAL AND A FAMILY UNIT WITH ONE INCOME RECIPIENT

		STATUS OF TAXPAYER						
GROSS EMPLOYMENT INCOME		UNATTACHED INDIVIDUAL	MARRIED COUPLE					
			NUMBER OF CHILDREN					
			0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	51.	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	49.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	−3.	0.	0.	0.	0.	0.	0.
2000	CURRENT TAX (1966 RATES)	115.	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	119.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	3.	0.	0.	0.	0.	0.	0.
2500	CURRENT TAX (1966 RATES)	202.	51.	13.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	199.	36.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	−3.	−15.	−13.	0.	0.	0.	0.
3000	CURRENT TAX (1966 RATES)	292.	115.	77.	38.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	281.	99.	8.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	−11.	−16.	−69.	−38.	0.	0.	0.
3500	CURRENT TAX (1966 RATES)	394.	202.	148.	102.	64.	0.	0.
	TAX UNDER OUR PROPOSALS	374.	172.	84.	35.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	−20.	−30.	−64.	−67.	−64.	0.	0.
4000	CURRENT TAX (1966 RATES)	499.	292.	238.	184.	130.	51.	0.
	TAX UNDER OUR PROPOSALS	471.	250.	161.	113.	65.	0.	0.
	INCREASE OR DECREASE IN TAX	−28.	−42.	−77.	−71.	−65.	−51.	0.
5000	CURRENT TAX (1966 RATES)	691.	499.	436.	373.	310.	202.	64.
	TAX UNDER OUR PROPOSALS	681.	421.	334.	287.	240.	147.	8.
	INCREASE OR DECREASE IN TAX	−10.	−78.	−102.	−86.	−70.	−55.	−56.
6500	CURRENT TAX (1966 RATES)	1018.	798.	732.	672.	615.	499.	310.
	TAX UNDER OUR PROPOSALS	1016.	698.	612.	567.	521.	430.	293.
	INCREASE OR DECREASE IN TAX	−2.	−100.	−120.	−105.	−94.	−69.	−17.
8000	CURRENT TAX (1966 RATES)	1384.	1128.	1062.	996.	930.	798.	615.
	TAX UNDER OUR PROPOSALS	1365.	989.	903.	858.	812.	722.	587.
	INCREASE OR DECREASE IN TAX	−19.	−139.	−159.	−138.	−118.	−76.	−28.
10000	CURRENT TAX (1966 RATES)	1940.	1644.	1566.	1488.	1410.	1254.	1040.
	TAX UNDER OUR PROPOSALS	1864.	1393.	1309.	1264.	1219.	1129.	997.
	INCREASE OR DECREASE IN TAX	−76.	−251.	−257.	−224.	−191.	−125.	−43.
12000	CURRENT TAX (1966 RATES)	2585.	2240.	2150.	2060.	1970.	1790.	1540.
	TAX UNDER OUR PROPOSALS	2400.	1817.	1733.	1688.	1644.	1556.	1427.
	INCREASE OR DECREASE IN TAX	−185.	−423.	−417.	−372.	−326.	−234.	−113.
15000	CURRENT TAX (1966 RATES)	3730.	3330.	3210.	3090.	2970.	2760.	2445.
	TAX UNDER OUR PROPOSALS	3265.	2507.	2424.	2382.	2339.	2253.	2128.
	INCREASE OR DECREASE IN TAX	−465.	−823.	−786.	−708.	−631.	−507.	−317.
20000	CURRENT TAX (1966 RATES)	5925.	5475.	5340.	5205.	5070.	4800.	4395.
	TAX UNDER OUR PROPOSALS	4839.	3828.	3748.	3707.	3667.	3586.	3465.
	INCREASE OR DECREASE IN TAX	−1086.	−1647.	−1592.	−1498.	−1403.	−1214.	−930.
25000	CURRENT TAX (1966 RATES)	8175.	7725.	7590.	7455.	7320.	7050.	6645.
	TAX UNDER OUR PROPOSALS	6572.	5356.	5279.	5241.	5203.	5128.	5016.
	INCREASE OR DECREASE IN TAX	−1603.	−2369.	−2311.	−2214.	−2117.	−1922.	−1629.
30000	CURRENT TAX (1966 RATES)	10620.	10120.	9970.	9820.	9670.	9370.	8920.
	TAX UNDER OUR PROPOSALS	8411.	7084.	7010.	6975.	6940.	6870.	6767.
	INCREASE OR DECREASE IN TAX	−2209.	−3036.	−2960.	−2845.	−2730.	−2500.	−2153.
40000	CURRENT TAX (1966 RATES)	15620.	15120.	14970.	14820.	14670.	14370.	13920.
	TAX UNDER OUR PROPOSALS	12300.	10868.	10795.	10763.	10730.	10665.	10568.
	INCREASE OR DECREASE IN TAX	−3320.	−4252.	−4175.	−4057.	−3940.	−3705.	−3352.
50000	CURRENT TAX (1966 RATES)	21065.	20515.	20350.	20185.	20020.	19690.	19195.
	TAX UNDER OUR PROPOSALS	16484.	15046.	14976.	14946.	14917.	14857.	14768.
	INCREASE OR DECREASE IN TAX	−4581.	−5469.	−5374.	−5239.	−5103.	−4833.	−4427.
70000	CURRENT TAX (1966 RATES)	32510.	31910.	31730.	31550.	31370.	31010.	30470.
	TAX UNDER OUR PROPOSALS	25462.	24024.	23957.	23930.	23903.	23850.	23769.
	INCREASE OR DECREASE IN TAX	−7048.	−7886.	−7773.	−7620.	−7467.	−7160.	−6701.
100000	CURRENT TAX (1966 RATES)	50955.	50305.	50110.	49915.	49720.	49330.	48745.
	TAX UNDER OUR PROPOSALS	39845.	38407.	38343.	38318.	38293.	38244.	38170.
	INCREASE OR DECREASE IN TAX	−11110.	−11898.	−11767.	−11597.	−11427.	−11086.	−10575.
200000	CURRENT TAX (1966 RATES)	119650.	118950.	118740.	118530.	118320.	117900.	117270.
	TAX UNDER OUR PROPOSALS	89840.	88402.	88338.	88314.	88290.	88242.	88170.
	INCREASE OR DECREASE IN TAX	−29810.	−30548.	−30402.	−30216.	−30030.	−29658.	−29100.

It is important to note that this table shows changes in taxes only in comparison with personal income tax rates that were in effect prior to the Budget Speech of December 19, 1966.

The proposed "integration" of personal and corporation income taxes would result in all corporate source income for residents being taxed only once—and then at the rate applying to each individual shareholder.

Briefly, this system would work this way:

Resident shareholders in Canadian corporations would include in their tax bases their full share of the corporate income paid or allocated to them. The amount of this dividend or allocation would be "grossed-up" to include the income tax already collected from the corporation.

The resident shareholder (but not the non-resident) would calculate his income tax and then would deduct a tax credit equal to the income tax already paid by the corporation on his share of its income. If the tax credit exceeded his tax liability, he would get a refund.

For example, suppose a shareholder in a 30 per cent tax bracket received a $50 cash dividend from a corporation which had been taxed at 50 percent.

For tax purposes, this shareholder would gross-up the dividend and bring into income the full $100—his share of the corporation's profits before taxes. His tax on that $100 would be $30. From this he would deduct the tax of $50 already collected from the corporation. Thus there would be a refund of $20. The total cash received by the shareholder would therefore be $70 (the $20 refund plus the $50 dividend). At present, such a shareholder in the same tax bracket would have $45 in cash after paying tax on the dividend.

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However, the benefit from integration would be partly offset in many cases by the taxation of realized share gains. Many of those who receive their income primarily from investments and have large capital gains would experience higher taxes despite integration.

From the Commission's estimates it is clear that most low and middle income shareholders would find their after-tax corporate source income (including capital gains) increased under these proposals.

The following table illustrates how taxpayers in some different situations would be affected by the integration system.

These calculations are based on three all-important assumptions:

1. The table deals only with those who receive all of their income from typical Canadian public companies.

2. Share gains are realized each year.

3. The taxable portion of the share gain is assumed to be equal to the cash dividend. And the cash dividend is assumed to be equal to one half of the corporation's after-tax profit.

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CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM (INCLUDING TAXES PAID BY CORPORATIONS) FOR A TAX UNIT WITH INCOME FROM A TYPICAL PUBLIC COMPANY

GROSS CORPORATE SOURCE INCOME		STATUS OF TAXPAYER: UNATTACHED INDIVIDUAL	MARRIED COUPLE — NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	591.	591.	591.	591.	591.	591.	591.
	TAX UNDER OUR PROPOSALS	54.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-537.	-591.	-591.	-591.	-591.	-591.	-591.
2000	CURRENT TAX (1966 RATES)	789.	789.	789.	789.	789.	789.	789.
	TAX UNDER OUR PROPOSALS	128.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-661.	-789.	-789.	-789.	-789.	-789.	-789.
2500	CURRENT TAX (1966 RATES)	986.	986.	986.	986.	986.	986.	986.
	TAX UNDER OUR PROPOSALS	212.	46.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-774.	-940.	-986.	-986.	-986.	-986.	-986.
3000	CURRENT TAX (1966 RATES)	1183.	1183.	1183.	1183.	1183.	1183.	1183.
	TAX UNDER OUR PROPOSALS	297.	111.	21.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-886.	-1072.	-1162.	-1183.	-1183.	-1183.	-1183.
3500	CURRENT TAX (1966 RATES)	1380.	1380.	1380.	1380.	1380.	1380.	1380.
	TAX UNDER OUR PROPOSALS	395.	189.	101.	52.	4.	0.	0.
	INCREASE OR DECREASE IN TAX	-985.	-1191.	-1279.	-1328.	-1376.	-1380.	-1380.
4000	CURRENT TAX (1966 RATES)	1577.	1577.	1577.	1577.	1577.	1577.	1577.
	TAX UNDER OUR PROPOSALS	495.	269.	181.	134.	87.	0.	0.
	INCREASE OR DECREASE IN TAX	-1082.	-1308.	-1396.	-1443.	-1490.	-1577.	-1577.
5000	CURRENT TAX (1966 RATES)	1971.	1971.	1971.	1971.	1971.	1971.	1971.
	TAX UNDER OUR PROPOSALS	714.	448.	361.	315.	269.	176.	37.
	INCREASE OR DECREASE IN TAX	-1257.	-1523.	-1610.	-1656.	-1703.	-1795.	-1934.
6500	CURRENT TAX (1966 RATES)	2571.	2563.	2563.	2563.	2563.	2563.	2563.
	TAX UNDER OUR PROPOSALS	1063.	737.	651.	606.	560.	469.	332.
	INCREASE OR DECREASE IN TAX	-1508.	-1826.	-1911.	-1957.	-2002.	-2094.	-2230.
8000	CURRENT TAX (1966 RATES)	3175.	3154.	3154.	3154.	3154.	3154.	3154.
	TAX UNDER OUR PROPOSALS	1423.	1037.	952.	907.	862.	772.	637.
	INCREASE OR DECREASE IN TAX	-1752.	-2117.	-2202.	-2247.	-2292.	-2382.	-2517.
10000	CURRENT TAX (1966 RATES)	3979.	3943.	3943.	3943.	3943.	3943.	3943.
	TAX UNDER OUR PROPOSALS	1942.	1457.	1372.	1328.	1284.	1195.	1063.
	INCREASE OR DECREASE IN TAX	-2037.	-2486.	-2571.	-2615.	-2659.	-2747.	-2880.
12000	CURRENT TAX (1966 RATES)	4784.	4744.	4732.	4731.	4731.	4731.	4731.
	TAX UNDER OUR PROPOSALS	2501.	1896.	1812.	1770.	1727.	1641.	1513.
	INCREASE OR DECREASE IN TAX	-2283.	-2848.	-2920.	-2961.	-3004.	-3090.	-3218.
15000	CURRENT TAX (1966 RATES)	5991.	5951.	5939.	5927.	5915.	5914.	5914.
	TAX UNDER OUR PROPOSALS	3400.	2615.	2533.	2492.	2452.	2371.	2249.
	INCREASE OR DECREASE IN TAX	-2591.	-3336.	-3406.	-3435.	-3463.	-3543.	-3665.
20000	CURRENT TAX (1966 RATES)	8003.	7963.	7951.	7939.	7927.	7903.	7885.
	TAX UNDER OUR PROPOSALS	4999.	3964.	3884.	3846.	3808.	3733.	3620.
	INCREASE OR DECREASE IN TAX	-3004.	-3999.	-4067.	-4092.	-4118.	-4170.	-4265.
25000	CURRENT TAX (1966 RATES)	9976.	9974.	9962.	9950.	9938.	9914.	9878.
	TAX UNDER OUR PROPOSALS	6748.	5512.	5435.	5400.	5365.	5296.	5191.
	INCREASE OR DECREASE IN TAX	-3229.	-4463.	-4528.	-4550.	-4573.	-4619.	-4687.
30000	CURRENT TAX (1966 RATES)	11948.	11948.	11948.	11948.	11948.	11926.	11890.
	TAX UNDER OUR PROPOSALS	8597.	7260.	7185.	7153.	7120.	7055.	6957.
	INCREASE OR DECREASE IN TAX	-3351.	-4688.	-4762.	-4795.	-4828.	-4871.	-4933.
40000	CURRENT TAX (1966 RATES)	15890.	15890.	15890.	15890.	15890.	15890.	15890.
	TAX UNDER OUR PROPOSALS	12496.	11058.	10986.	10956.	10927.	10867.	10778.
	INCREASE OR DECREASE IN TAX	-3395.	-4832.	-4904.	-4934.	-4963.	-5023.	-5112.
50000	CURRENT TAX (1966 RATES)	19833.	19833.	19833.	19833.	19833.	19833.	19833.
	TAX UNDER OUR PROPOSALS	16694.	15256.	15187.	15158.	15130.	15073.	14988.
	INCREASE OR DECREASE IN TAX	-3139.	-4577.	-4646.	-4674.	-4703.	-4759.	-4844.
70000	CURRENT TAX (1966 RATES)	28155.	27755.	27718.	27718.	27718.	27718.	27718.
	TAX UNDER OUR PROPOSALS	25692.	24254.	24187.	24160.	24133.	24080.	23999.
	INCREASE OR DECREASE IN TAX	-2463.	-3501.	-3531.	-3558.	-3584.	-3638.	-3719.
100000	CURRENT TAX (1966 RATES)	41398.	40948.	40813.	40678.	40543.	40273.	39868.
	TAX UNDER OUR PROPOSALS	40091.	38653.	38588.	38564.	38540.	38492.	38420.
	INCREASE OR DECREASE IN TAX	-1308.	-2296.	-2225.	-2114.	-2003.	-1781.	-1448.
200000	CURRENT TAX (1966 RATES)	86586.	86086.	85936.	85786.	85636.	85336.	84886.
	TAX UNDER OUR PROPOSALS	90090.	88652.	88588.	88564.	88540.	88492.	88420.
	INCREASE OR DECREASE IN TAX	3504.	2566.	2652.	2778.	2904.	3156.	3534.
350000	CURRENT TAX (1966 RATES)	156767.	156167.	155987.	155807.	155627.	155267.	154727.
	TAX UNDER OUR PROPOSALS	165090.	163652.	163588.	163564.	163540.	163492.	163420.
	INCREASE OR DECREASE IN TAX	8323.	7485.	7601.	7757.	7913.	8225.	8693.
600000	CURRENT TAX (1966 RATES)	277024.	276374.	276179.	275984.	275789.	275399.	274814.
	TAX UNDER OUR PROPOSALS	290090.	288652.	288588.	288564.	288540.	288492.	288420.
	INCREASE OR DECREASE IN TAX	13066.	12278.	12409.	12580.	12751.	13093.	13606.
1000000	CURRENT TAX (1966 RATES)	474861.	474161.	473951.	473741.	473531.	473111.	472481.
	TAX UNDER OUR PROPOSALS	490090.	488652.	488588.	488564.	488540.	488492.	488420.
	INCREASE OR DECREASE IN TAX	15229.	14491.	14637.	14823.	15009.	15381.	15939.

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The Commission analyzed the effects the proposed new tax system would have on the volume and allocation of saving and investment. It is satisfied that despite the major increase in corporation tax collections and the substantial increase in the weight of tax on many high income individuals and families, total domestic saving would not be reduced.

By adopting a more neutral tax system the allocation of capital would be much improved, with the result that future production would be increased without forcing Canadians to save more, and without Canada relying more heavily on foreign saving.

The Commission said that the low rate of tax on the first $35,000 of corporation income, percentage depletion for the extractive industries, the three-year exemption for new mines, and the failure to tax adequately the business income of life insurance companies, are extremely costly in terms of revenue and are inefficient incentives.

It believes that the first one should be replaced by a more efficient incentive, the next two should be withdrawn and life insurance companies should be taxed like other businesses. The revenue saving could be used to lower taxes on marginal investments in other industries that have higher expected rates of return.

By allowing mining and petroleum companies to deduct all of their costs before paying any tax, and by giving resident shareholders of the companies full credit for the corporation tax, the impact of the removal of the concessions would be mitigated. In fact, the immediate write-off of costs would mean that companies with substantial new investment would continue to pay little or no tax. In particular, most of the smaller companies would not be affected by the withdrawal of depletion and the

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three-year exemption for new mines.

By allowing the deduction of business losses that now are disallowed, and by allowing new and small businesses to write off their capital costs more rapidly, the biases of the market against some companies would be compensated for more effectively.

By giving residents full credit for Canadian corporation tax collections the shares of Canadian companies would be a much more attractive investment than they now are to most Canadians, and to the institutions through which much of Canada's personal saving is channeled.

The Commission expects that, despite the full taxation of share gains, the prices of Canadian equities would rise. This would encourage a more rapid rate of capital investment by most Canadian companies that now do not benefit from special industry tax concessions. It would also encourage non-resident-controlled Canadian subsidiaries to offer shares to Canadians.

Should Canadians want greater increases in the rate of economic growth, the Commission recommends changes in the "mix" of monetary, fiscal, trade and exchange rate policies.

The Commission's second choice is the adoption of a system of investment tax credits and less stringent limitations on deductions for Registered Retirement Income Plans. The Commission emphasizes that it is unnecessary to reduce the progressiveness of the tax system to encourage more saving, when the same result could be obtained in other ways that would not reduce the fairness of the system.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 2

SALES TAXES

OTTAWA — The 11 per cent federal sales tax now applied at the manufacturing level to most consumer goods should be abolished and replaced by a 7 per cent federal sales tax to be applied at the retail level to both consumer goods and services, the Royal Commission on Taxation recommended today.

Food, shelter and producer goods would be exempt from the proposed retail tax. In fact most of the present exemptions from the manufacturer's tax would continue to apply and some additional items—prescription drugs, for example—would also become exempt under the Commission's proposals.

The Report recommends that initially only a limited number of defined services should be taxed, in order to ensure that only those services not entering directly into production are subject to tax. But the Commission suggested that eventually a broad range of consumer services should be taxed.

The 7 per cent rate at the retail level would raise almost as much federal revenue as the 11 per cent rate at the manufacturer's level—which many consumers are seldom conscious of paying—but the average federal sales tax burden on those with incomes below $10,000 a year would decline by about 10 per cent.

Because the proposed 7 per cent rate would mean some reduction in federal sales tax revenues, the change in the level at which the sales tax is applied should not cause any general price increases, the Commission said.

Where a province has a general provincial sales tax rate of 5 per cent, the Commission's proposals would result in a total tax at the

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retail level of about 12 per cent. Nine of the provinces—all except Alberta—now have either enacted or announced sales taxes ranging from 4 to 6 per cent.

If the federal government accepts the new retail sales tax base and rate, the Commission said it then should negotiate to have the same tax base adopted by the provinces, which then might do the entire job of collecting sales taxes.

The provinces should be permitted to impose an indirect retail sales tax, the Commission recommends. At the present time the constitution limits the provinces to direct taxes.

The Commission indicated it would prefer to see no federal sales tax at all in Canada. But it could not countenance the massive increase in income taxes that would be necessary to match the revenue that a federal sales tax yields.

In designing the proposed new federal retail sales tax, the Commission provided specific exemptions to prevent "regression"—the unfair burden of tax imposed on low income families due to the fact that they spend a heavier proportion of their incomes on taxable goods and services than upper income families.

Exempt from the proposed new tax would be all food, including soft drinks, candy and inexpensive restaurant meals; shelter, including houses and rents, and fuel and electricity; all educational services; the services of hospitals, doctors, dentists, nurses, lawyers and undertakers; books, newspapers and magazines; and prescription drugs, and appliances and devices for the handicapped.

Also exempted would be producer goods, goods for export, and

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finished buildings and structures. Producer goods would include raw materials and unfinished goods, production equipment and machinery, and capital goods used in distribution and services. The government recently enacted legislation providing for the removal of the tax on production equipment in stages; the Commission recommends it be removed immediately.

Eventual removal of sales tax on building materials also was recommended in today's Report. But the Commission said that, while it could find no economic or social justification for imposing such a tax in the first place, it now is impossible to lift it immediately because the federal revenue loss would be too great. Meanwhile, shifting the tax to the retail level and applying a lower rate would result in an effective 30 per cent cut in the tax on most building materials.

The Commission recommended that special excise taxes on certain so-called "luxury goods" be repealed immediately. This would remove existing levies from radio and TV sets, phonographs, electronic tubes, cosmetics and toilet goods, clocks and watches, jewellery, playing cards, coin-operated amusement machines, cigarette lighters, matches, pipes, cigarette holders and cigarette-rolling machines.

But the excise taxes and excise duties on alcohol and tobacco products should be retained, the Commission said. These "extraordinarily heavy" levies now yield an enormous amount of revenue—about 10 per cent of all federal budgetary revenues—and have widespread public acceptance, "facilitated by the prevailing attitude that these goods are injurious and should be expensive."

All told, the federal retail sales tax as proposed by the Commission would apply to a wide range of goods which in 1964 had a retail

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sales value of about $17 billion, including about $4 billion worth of building materials.

The taxable sales would include—on the basis of 1964 personal expenditures—about $4 billion in automotive products, $2.8 billion in clothing and footwear (there would be no special exemption for children's clothing), $1.2 billion in furniture and appliances, and about $1 billion worth of alcoholic beverages.

Services that are proposed to be taxed immediately—those that generally do not enter into production costs—had a sales value of $4 billion as of 1964. About one quarter of this was telephone and telegraph services. Another quarter was accounted for by hotel, motel and similar accommodation and services (excluding liquor). The balance would include auto and other kinds of repairs and services by retail establishments, laundry and dry cleaning services, restaurant meals above some tax-exempt minimum, barber and beauty shops, dressmaking and photographic services, etc.

All told, the Commission estimates that total federal sales tax revenues as of 1964 would have been $1,472,000,000. This is $125,000,000 <u>less</u> than was yielded in that year by the 11 per cent manufacturer's sales tax and the particular excise taxes that the Commission proposed should be removed.

The Commission proposes this change in the level at which sales tax is levied as a means of achieving a measure of neutrality in the impact of the sales tax. The application of the tax at the retail level would ensure that all taxable goods bore a similar element of tax, and that many of the present problems of determining the amount that should be taxed would no longer exist. The exemption for producer goods and exports would be more

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readily administered. Imports would clearly bear the same tax as domestically produced goods.

The retail tax automatically and simply achieves the neutrality that a tax levied at earlier levels in the process of production and distribution cannot achieve. Regardless of the distributional channels used, of who advertises, packages or imports, etc., the cost elements that ultimately determine the selling price of an article to the consumer converge at the point of imposition of a retail tax.

The Commission said that only at this tax level can it be said that neutrality is achieved without sacrificing simplicity, or that simplicity is achieved without sacrificing neutrality.

The Report states that a retail tax avoids the alleged pyramiding effect—that is, the marking-up of the tax element in the price of goods as they pass through the various stages of distribution. In addition, only a tax at the retail level can avoid the inequities that inevitably arise with a tax at any other level because some entrepreneurs must hold tax-paid inventory.

The Commission also recommended that the federal government should try to negotiate an exchange of more sales tax room for the provinces in return for more direct (income) tax room for the federal government. The Report opposed any further abatement of personal and corporation income taxes to the provinces.

Meanwhile, sales tax exemptions for purchases by other governments and their agencies should be eliminated, the Commission said. If necessary, they could be compensated through increased grants or other fiscal arrangements. This would not change their net position, but would eliminate costly

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administrative problems and the discrimination that would arise when government agencies use tax-exempt goods and services in competition with non-exempt businesses.

One large administrative problem would arise in shifting the federal sales tax to the retail level: goods on which the manufacturer's tax already was paid would be included in inventories at change-over time.

To avoid double taxation--the piling of the new retail tax on top of the manufacturer's sales tax which already had been paid--the government would have to postpone about $175,000,000 in revenue from the new tax, the equivalent of one and one-half months of federal sales tax revenues. The Commission considers this a justifiable price to pay for the various benefits in the new tax.

What would the tax transition do to retail prices?

"The full blaze of national publicity that would accompany the change of the sales tax base should exert a restraining influence on those manufacturers who have the market power to raise prices and who would be tempted to capitalize on the transition", the Commission said.

"However, the combination of necessary price increase on certain goods, and the uncertainty of retailers as to the precise amount of tax that had been concealed in their purchase prices under the manufacturer's tax, could encourage some manufacturers and merchants to increase their prices.

"It is also possible that the prices of certain types of goods, notably goods that have traditionally carried a specific retail price, and those that are commonly subject to 'suggested retail prices', might be rigid enough to continue beyond the transitional interval, thereby imposing higher costs on consumers.

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"It seems reasonable to expect, however, that competition would force the appropriate price adjustments within a relatively short period of time. Nevertheless, we feel that a concerted public information programme, to inform individuals and firms as to the substance and mechanics of the change of base, would be necessary to increase the competitive pressures."

Variation in spending patterns among households would result in some variations in the amounts of sales tax paid on goods and services purchased by families with a given income. But such variations are small, compared with variations in income taxes.

The following table shows the estimated change in average federal sales taxes paid by families in different income classes under the current and proposed systems:

Income Class	Average Federal Sales Taxes Paid: Current	Average Federal Sales Taxes Paid: Proposed	Average Change in Tax	Percentage Change
Less than $2,000	80	78	-2	-3
$2,000 - $2,999	144	131	-13	-9
$3,000 - $3,999	212	187	-25	-12
$4,000 - $4,999	252	218	-34	-13
$5,000 - $6,999	347	303	-44	-13
$7,000 - $9,999	503	435	-68	-14
$10,000 and over	722	856	134	+18
All classes	269	248	-21	-8

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 3

INTEGRATION

OTTAWA — The proposed "integration" of personal and corporation income taxes is the best and fairest of all possible methods of taxing corporate income, the Royal Commission on Taxation says in its Report published today.

The integration system is packaged by the Commission with two other major proposals—the full taxation of realized capital gains, including gains on the sale of shares; and the reduction of the top rate of personal income tax to 50 per cent. The existing 20 per cent dividend tax credit would be abolished.

Briefly, this is how the proposed new system would work:

All corporations would be taxed at a single flat rate of 50 per cent of their income. Rates of tax on individual and aggregated family incomes would rise progressively with the size of those incomes, but the rates would be lower than at present and the top rate would be 50 per cent.

Resident shareholders in Canadian corporations would add to their taxable income their full share of the corporate income paid or allocated to them. The allocation procedure would be similar in effect and result to the declaration by the corporation of a stock dividend except that new shares would not be issued. The amount of this dividend or allocation would be "grossed up" to include the income tax already collected from the corporation.

The shareholder resident in Canada (but not the non-resident) would calculate his income tax on his combined personal and corporate income, and from his total tax liability he would then deduct a tax credit

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equal to the full amount of the income tax already paid by the corporation on his share of its income. If the tax credit exceeded his tax liability, the shareholder would get a tax refund.

However, the total tax liability of shareholders on corporate source income would also include the proposed taxation of realized capital gains, with the result that the after-tax corporate source income of many upper income shareholders would be reduced and not increased. Nevertheless, most low and middle income shareholders would find their after-tax corporate source income increased by these proposals.

To illustrate how the integration proposal would operate, suppose that a resident shareholder received a $50 cash dividend from a corporation which had been taxed at the rate of 50 per cent. He would ultimately pay only his personal rate of tax on an original income of $100 at the corporate level.

The following table shows how taxpayers in three different tax brackets would be treated under this system, using the above example:

	Shareholder's Tax Bracket		
	15%	35%	50%
Income (grossed-up dividend)	$100	$100	$100
Personal Tax	15	35	50
Less tax paid by corporation	-50	-50	-50
Tax Refund	35	15	—
Plus the cash dividend	50	50	50
Total cash to the shareholder	85	65	50

Tax-exempt organizations (Registered Retirement Income Plans, charities, etc.) would receive credit for the full amount of the corporation income tax.

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In effect, this would mean a fundamental change in the corporation income tax as it has been known in Canada since 1917. Corporate income would still be taxed—but only once, and then at the rate that applies to the entire income of the shareholder.

Combined with the proposed taxation of realized share gains, the total net gains from the ownership of shares by residents in Canadian corporations would be taxed neither more nor less than the net gains from employment, from operating a business as a partner or proprietor, from holding real property, or from holding bonds.

The taxing of all income at the same rates would remove many of the present distorting effects of the tax system that have resulted in certain procedures being followed because they would reduce taxes and not because they would increase the total income of the business.

"Surplus-stripping" activities would largely disappear, the problem of associated corporations would no longer be significant, the primary tax advantage of issuing debt rather than equity capital would be removed, and the differences in tax treatment between ordinary corporations and other business organizations (such as non-incorporated businesses, co-operatives, credit unions, etc.) would be ended.

In general, Canadians would find investment in Canadian corporations to be relatively more attractive, so that equity ownership by Canadians in Canadian companies should increase, while the lower cost of capital to Canadian companies should improve their competitive position.

The proposed integration system would have two other main features:

1. The corporation would be allowed to allocate after-tax

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corporate income to shareholders without having to pay cash dividends.

2. When the corporation allocates retained corporate earnings to the shareholder, the cost basis of the shares should be increased so that share gains resulting from the retention of earnings that had been taxed to the shareholder would not be taxed again to the shareholder when realized.

The Commission estimates that this system would mean substantial tax relief for low and middle income Canadian shareholders, particularly those holding shares in large income, dividend-paying Canadian corporations.

But there would be little if any benefit for upper income shareholders.

They would benefit from the reduction in the top personal rate. And they would pay no further tax on dividends. But bringing capital gains into their taxable income could more than offset these benefits, since it is estimated that those with large incomes now have tax-free capital gains that are at least as large as their taxable dividends.

Many non-resident shareholders would be worse off. The Commission estimates that its full range of tax reforms would reduce the overall impact of taxation on corporate source income (including share gains) by about $50,000,000 for Canadians, but would raise it by about $270,000,000 for non-residents.

However, this effect on non-residents is due to other factors than the integration system--chiefly the withdrawal of existing special tax concessions for mining and petroleum companies and certain financial institutions, in which a heavy proportion of the non-resident share ownership is concentrated.

Canadian consumers--and the whole economy--would also benefit

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from the integration system, the Commission said.

The Report points out that when income tax is collected from a corporation, it does not mean that the corporation bears the burden of the tax.

Ultimately, corporation taxes are "passed on" in two ways:
(1) through immediate increases in prices, or reduction in costs, that will quickly restore the after-tax rate of return on corporate assets;
(2) through gradual increases in product prices (relative to what they would otherwise be) resulting from reduced capital spending and lower output.

In the first case, the corporation tax in effect becomes a crude and regressive sales tax. In the second case it becomes a crude and unfair tax on wealth, because the tax is borne by those who happen to hold shares at the time the tax is imposed; these shareholders bear the tax because it is reflected in lower share prices.

In either case, consumers are worse off. Either their real purchasing power is reduced because of higher prices or lower wages, or there are fewer goods and services available.

Under integration of personal and corporation income taxes, there would also be two possibilities: (1) the tax reduction on corporate source income could be quickly passed on to consumers through lower prices, or to workers through higher wages; (2) to the extent that the tax reduction was not shifted in these ways, the higher after-tax rate of return to shareholders would stimulate more capital investment, which in turn should increase productivity and increase the supply of goods and services.

Either way, Canadians as a group would be better off and "this would be the principal benefit of integration," the Commission said.

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But under integration there is a third possibility: the tax reduction could continue to be completely capitalized in higher share prices.

This would be likely to happen, however, only when the corporation is completely insulated from the competition provided by the entry of new firms attracted by the higher after-tax rate of return to shareholders. And the Commission said few corporations have such a monopoly position. The Report added:

"We are confident that the instances of full capitalization of the tax reduction without favourable price and output effects would be the exception rather than the rule. To deny the tax reduction because the shareholders of a few corporations would obtain windfall share gains would be to cut off our collective noses to spite our collective faces. We would be denying ourselves greater output from the economy generally to ensure that the few did not get what they did not deserve. There are other methods for dealing with corporations that have massive and persistent monopoly power. To design a tax system to suit the exceptional case would be to lose all perspective."

Some other advantages of the integration system:

—The increase in Canadian share prices should encourage non-residents holding shares in Canadian corporations to sell them to Canadians, and Canadian subsidiaries of foreign parent corporations would be encouraged to raise capital by selling shares to Canadians.

—Since one flat rate of tax would be collected from corporations (the existing lower rate on the first $35,000 of corporation income would be abolished), tax avoidance through the creation of associated companies to take advantage of the dual rate would be eliminated.

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—The opportunities for and advantages of "surplus-stripping" and other methods of tax avoidance that are inherent in the present tax structure would be removed.

"Several parts of the present law could be eliminated, while the uncertainty and complexity of other parts would be reduced," the Report added.

"No other method of taxing corporate source income which we have considered has these desirable attributes."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 4

CAPITAL GAINS

OTTAWA — The full taxation of all capital gains, coupled with the full deductibility of losses, has been recommended by the Royal Commission on Taxation to achieve fairness and certainty in the tax system.

Gains from the sale of houses and farms would be exempt, up to a lifetime limit of $25,000. Losses on houses would not be deductible, but losses on most other property—except personal-use items—would be.

The present investment income surtax, a levy of 4 per cent on income from foreign investments, would be repealed.

Taxation of property gains would <u>not</u> be retroactive; only those gains in excess of the market value of properties—including securities—at the effective date of the legislation would be brought into income when realized.

The Commission agreed with those who claim that the full taxation of capital gains under Canada's present tax system might be disastrous. But under the Commission's overall recommendations this basic tax system would be so radically altered that bringing capital gains into taxable income would be both fair and workable, the Report said.

Other features of the new system:

—Greatly reduced marginal rates of personal tax, with the maximum rate limited to 50 per cent.

—Canadian shareholders would get 100 per cent tax credits for income taxes collected from Canadian corporations.

—New income-averaging provisions of "unparallelled liberality".

—More efficient incentives for new and small businesses.

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—Generous treatment of business losses, removing any remaining tax bias against risk taking.

—Registered Retirement Income Plans to receive the full credit for corporation taxes on corporate source income attributable to them, and to be exempt from tax on corporate source income (including share gains) received.

—Elimination of the present gift and estate taxes and the taxing of gifts and inheritances in the hands only of persons who are not in the same family tax unit as the donor.

"As one component of a package with these features, we can dismiss the claims that to tax capital gains would destroy initiative, reduce saving, and drive people out of the country," said the Commission.

The proposal need not depress security prices, the Report added. The new system's effect on the stock market would depend on the taxation of income in general, and corporate source income in particular—and not merely on the taxation of gains on securities.

Indeed, the Commission envisaged that with full credit for taxes paid by Canadian corporations, Canadians will find it more attractive to hold shares. Therefore the demand would rise, and so would prices.

The revenue effects of taxing capital gains are difficult to estimate, since accurate figures are not available on the total amounts of such gains.

However, even if there were no change in revenue, the Commission said it would have recommended the taxation of capital gains on the basis of equity—the overriding principle underlying its whole Report.

The Commission points out that the administration of the proposed taxation of property gains, once the transitional difficulties are taken

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care of, would be much simpler than the present system: there would be little need to differentiate between kinds of income, since all forms of income would be subject to similar taxation.

The existing method of dealing with property gains was described as grossly unfair.

As the system stands now, a gain realized on property that is regarded as an investment is held to be "capital" and therefore not taxable. But if a property gain arises from carrying on a business, it is regarded as "income" and is taxable.

But it's a hairline distinction. The Income Tax Act does not define "income", let alone "capital" or "capital gain". So the difference between the two kinds of gains has been left to the courts. If they find a particular gain to be "capital", the transaction escapes tax.

Thus there is an enormous incentive to the taxpayer to try to transform "income" gains into "capital" gains. Many succeed. One result is that some wealthy people with large property income pay proportionately less tax than some low and middle income families.

Anotner example of unfairness: suppose one man works overtime to earn enough money to buy a car, while another buys a car out of his net gains in the stock market. One buys the car with taxed income, the other with non-taxable income.

The Commission also noted a tendency in recent years for the authorities to seek to tax gains on the sale of real estate, but not to assess gains on the sale of marketable securities. "...there appears to be neither logic nor equity in taxing the gains on one type of asset and not on the other," said the Report.

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The only equitable basis for taxation, said the Commission, is to include in a comprehensive tax base the value of all additions to economic power. Put more simply: "It is what you get, not how you get it, that should count for tax purposes."

Said the Report:

"It may have been appropriate in years past to distinguish, for tax purposes, between gains flowing from property and those resulting from the acquisition and disposition of property, but in the current business and investment environment such a distinction has little if any significance.

"We are convinced that the failure to tax capital gains in Canada has no basis in principle; that it has led, and will continue to lead, to uncertainty as to which gains on the disposition of property are taxable and which are not; and that it affronts all the standards of equity and neutrality which we feel should characterize a tax system.

"In our view the exclusion of capital gains is no longer defensible, if it ever was. We are convinced that the time has come to abandon this exclusion and to replace it with a more logical, certain and equitable basis of taxation."

In both the United States and Britain, some capital gains are taxed at reduced or preferential rates. Thus the proposal to tax capital gains in Canada at full rates may seem harsh.

However, the Commission said it believes that the U.S. and British preferential rates may be attributable in whole or in part to very high progressive rates of tax, or the lack of comprehensive income-averaging provisions. Neither situation would exist under the proposed Canadian system.

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The integration of personal and corporation income taxes proposed by the Commission would also be a major mitigating factor.

Neither the U.S. nor the British tax system gives shareholders credit for underlying corporation tax. This means that retained earnings are taxed at the corporate level and the share gains resulting from the retention of earnings are taxed again to shareholders when realized.

Under the proposed Canadian integration scheme, retained earnings would be allocated to shareholders and therefore would be taxed at their marginal rates. Consequently, only share gains in excess of those resulting from the retention of earnings by the corporation would be taxed to the shareholder when realized.

If half of the increase in the price of the shares is attributable to the retention of earnings, the Commission's proposal would mean that only the remaining half of the price increase--the "goodwill gain", as the Report describes it--would be taxed at full personal rates.

This would give the same result as taxing the whole increase in price at half personal rates, as is done in Britain and the United States. Generally, Canadian corporate source income (including share gains) would be taxed less heavily to residents than this kind of income is taxed in the U.S. and Britain--particularly for low and middle income shareholders.

Some features of the Commission's proposal follow:

Residents--both individuals and corporations--would be taxed on world-wide capital gains, just as they now are taxed on world income. The foreign tax credit would be extended to cover foreign taxes on capital gains.

A non-resident carrying on business through a permanent establishment in Canada should be taxed on gains on property used in that

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business. The ownership of real property in Canada would be deemed to constitute a permanent establishment. Thus gains on real property owned by non-residents would be taxable. But the non-resident would not be taxed on other property gains; such taxation would be too difficult to administer and enforce.

When an individual or corporation left Canada, there would be a deemed disposition of property at fair market value. This would stop people from escaping the capital gains tax by fleeing the country. Under the procedure recommended by the Commission, people who were emigrating would be required to produce a tax clearance—obtainable only after filing a final tax return bringing accrued property gains into taxable income.

When a person entered Canada to live here, there would be a deemed acquisition by him of his property at fair market value.

Property gains would be deemed to be realized on death. But such gains would not be taxed at that time if the property passed to a surviving spouse or other members of the "family unit" as defined by the Commission. All transactions within a family would be non-taxable.

Annual tax returns would include information on all securities and real property owned. Particulars of all property gains and all deductible property losses would also be required.

All losses would be taken into account in computing income, except losses on items held for personal use. Thus losses on houses would not be allowed.

Some transactions affecting property would not give rise to either a taxable gain or a loss, although the gain or loss would eventually be included in income. Among these:

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—A loss or destruction of property that gave rise to payment of insurance or damages, if the proceeds were reinvested in similar property within a reasonable time.

—Expropriation of property, if the proceeds were reinvested in similar property within a reasonable time.

—Transfer of property to a new corporation in exchange for its shares.

—Exchanges of shares and transfers of property on certain corporate reorganizations.

—Pledging of property by way of security for an obligation.

At the effective date of legislation implementing taxation of capital gains, one difficulty would be the establishment of fair market values for property held at the time.

There would be little difficulty in determining the values of publicly traded securities. Non-residential real estate would pose some problems, but appraisals would not be difficult to obtain in most cases. The major area of uncertainty would be unincorporated businesses and private companies, where valuations are usually made only at the time of sale or for estate or gift tax purposes.

The Commission said the taxpayer should be given the option of seeking official approval for a detailed valuation of such property, or of computing an arbitrary value when the property is ultimately disposed of by apportioning the gain over the total time the property was held.

Interest Income

As for interest, the Commission recommends that uncashed matured bond coupons should be treated as income when they become due, even if they are not then cashed.

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A similar problem arises with an investment certificate which provides for retention and reinvestment of the annual interest until a future date. At present, interest is not taken into income until paid. The Commission recommends that taxpayers be required to report interest income when it has been credited to them. But for administrative convenience, inclusion of amounts less than $10 for each taxpayer would not be required.

Where payments of principal and interest are blended—as in mortgage payments—the payee would be required to make a reasonable allocation.

One existing problem is the failure of taxpayers to report interest. To overcome this, the Commission recommends that all corporations, governments and government organizations be required to withhold tax at a rate of 15 per cent on all interest, either paid or credited.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 5

EMPLOYMENT INCOME

OTTAWA — The right to deduct expenses reasonably related to the earning of income would be granted to employees for the first time under the recommendations of the Royal Commission on Taxation.

Such expenses now can be deducted only by businesses and the country's 500,000 self-employed. The result is that they are being taxed on "net" income, while about 4,500,000 employees—who do not have the same privilege—are taxed on "gross" income.

To end this unfairness, the Commission would allow all employees to deduct from income their actual expenses (but not commuting expenses or club dues), or to claim an optional standard deduction equal to 3 per cent of their income up to a maximum of $500 a year.

Other major proposals concerning employment income:

—New rules on fringe benefits and other non-cash "benefits in kind" should require employers to allocate the fair market value of these to each employee, who would be taxed on that value. As an alternative to allocation the employer could pay a special tax equal to the market value of the benefits.

—Tough new arbitrary limits should be applied to travelling and entertainment expenses. Any employee who overspent these limits should be regarded as having received a benefit, and the excess should be taken into his taxable income, or made subject to the special tax on employers.

The Commission said the problem of "expense account living" may not be of great significance from a revenue point of view. The amounts involved are probably relatively small.

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"But the suspicion that some are enjoying exotic holidays, lavish food and drink and expensive entertainment out of untaxed income is demoralizing even if frequently ill-founded.

"Seeking out new tax dodges becomes a game; boasting about 'getting away' with an outrageous abuse, a pleasure; hearing of the opportunities missed, a torment.

"To stop 'expense account living' we propose some arbitrary rules that undoubtedly will be castigated as unreasonable. We frankly admit that some of them are stringent. That is exactly what we intend.

"The problem of taxpayer morale is serious and the strongest measures are called for. We deny that the rules we propose are unreasonable, however, relative to the alternatives. This is an area where generalities are useless and specific—if arbitrary—rules are the only solution."

Some of those rules:

—On bona fide business trips, actual transportation costs should be allowed. There should be a specified limit for meals and lodging; the Commission suggested that $25 daily would be enough, at current prices. Limits on conference fees should be set at two a year, at $35 to $50 each.

—Limits on bona fide business entertainment bills should also be stipulated in the regulations. The Commission said an upper limit of $5 to $10 a day per person entertained would be about right at current prices. The employer should be required to keep detailed records of who was entertained, where, at what cost, and why.

—The value of the personal use by an employee of his employer's car or aircraft should be taken into the employee's income, or taxed to the employer as above. For aircraft, a detailed log would have to be kept showing for each trip the names of passengers carried, the points of

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departure and destination, and the purpose of the trip.

The Commission said that if experience showed that its proposed procedure on entertainment expenses was being abused or proved unenforceable, then all entertainment expenses should be added to the income of the employee or taxed to the employer in the stipulated manner. This procedure would be similar to that in Britain, where such expenses are disallowed.

Basically, the same approach should be followed by the Commission in the proposed new tax treatment of non-cash benefits to employees.

The existing law says these benefits are taxable. But it cannot be effectively enforced. The result is that there is discrimination: some employees can arrange to receive part of their remuneration in the form of untaxed fringe benefits, while others cannot.

"With literally millions of transactions taking place every month, general provisions such as those currently on the statute books are, to a substantial degree, an empty gesture," the Commission said.

"It would take an army of assessors and a battery of courts to apply the law effectively. A system consisting of a few general but unenforceable provisions inevitably degenerates into one where a few are capriciously taxed while the abuses of the many go untouched.

"We are reluctant to recommend arbitrary tax provisions, but we are convinced that arbitrary provisions that err on the side of liberality and are fully enforced would provide more real (if rough) justice than general provisions that are inconsistently enforced."

The Commission recommended that the Income Tax Act include a general charging provision that would bring into the tax base of an individual or family tax unit all forms of employment income and the value of all deemed benefits to the employee.

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If the employer was unable or unwilling to allocate these benefits to the individual employees concerned, he should pay the special tax mentioned earlier at the top personal rate on the before-tax income that an individual paying tax at that rate would have had to receive in order to buy the benefit in the market with after-tax income.

The special tax would itself be deductible in computing the employer's income.

Therefore, there would be no tax saving—and possibly an increase in the tax cost—if the employer provided non-cash benefits that were not taxed to the employee.

Included in income would be lump sum payments such as those for loss of office, retiring allowances, death benefits, bonuses, distributions from profit-sharing plans and stock option benefits. Since the Commission has recommended new and more liberal income-averaging provisions, it said no special relieving provisions would be necessary to ease what otherwise would be a sudden increase in taxes.

Stock option benefits should become taxable in full when the stock is acquired by the employee.

Premiums for government hospital insurance and medical insurance premiums paid by employers on behalf of employees should be brought into the income of employees. Otherwise they would be subject to the special tax on employers.

Free, subsidized or discounted goods and services provided to employees should be taxable as benefits to them, or subject to the special tax on employers. Included would be meals, housing, schools for employees'

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children, loans, transportation passes, recreational facilities including summer cottages and lodges and fishing and hunting camps, and yachts and golf courses.

All club, union and association fees or dues paid by an employer on behalf of an employee should also be included in the employee's income.

Tax-free allowances now paid to Members of Parliament and Members of the provincial legislatures would be affected by the Commission's recommendations. The amount of these allowances would be taken into their income. However, the actual expenses of the members would be allowed as deductions from income for tax purposes. A member's riding would be deemed to be his home, so that his actual living expenses while attending sessions would be deductible as would travelling expenses.

Under the proposed new system, strike pay also would be included in the incomes of union members when received, or else the union would have to pay the special tax in the same way as employers would on other benefits.

"Since strike pay is a form of benefit under an informal income maintenance insurance scheme, there is no doubt that it is income to the recipient," the Commission said. "This would not involve 'double taxation' because union dues would be deductible to the members."

Some benefits provided by employers would be excluded from the employee's income, because the amounts involved would be too trifling to make it administratively worth while to include them, or because they could not be said to confer a true benefit on the employee.

Excluded would be employer subsidies to community schools, special clothing provided by employers, necessary moving expenses paid by

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the employer, and tools and equipment provided by the employer for use in day-to-day work.

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 6

GIFTS AND BEQUESTS

OTTAWA — Proposals by the Royal Commission on Taxation for the taxation of gifts and bequests would be accompanied by such liberal annual, lifetime and family exemptions that most people would never pay tax on any gifts or bequests.

However, existing gaping holes in the tax net would be patched to capture large gifts made by wealthy people, and the result would be a substantial increase in revenues from this source—from about $140,000,000 to about $350,000,000 annually.

"The present tax is so readily avoided that it is almost useless," the Commission said.

The proposal change is based on this principle:

"The allocation of taxes according to ability to pay requires the imposition of progressive rates of tax on a tax base that measures the change in the economic power of each individual and family.

"No one can doubt that gifts increase the economic power of those who receive them, for they either "save the pocket" or provide an asset that can be exchanged for consumer goods and services....

"As we have stressed, the source of a gain and the expectations and intentions of the recipient of a gain are completely irrelevant. Anything that increases an individual's or a family's capacity to command goods and services should be included in the tax base.

"However, in order to simplify administration, by reducing the need to value and account for many small gifts, we will propose that there should be certain annual exemptions, as well as a lifetime exemption, for gifts received."

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The Commission recommends that the existing estate and gift taxes be repealed, and that henceforth all gifts be brought into the recipient's comprehensive income tax base and taxed at full progressive rates in the same way as wages or salaries, business income, dividends, interest, capital gains and windfalls.

But there would be one major exemption: no transaction of any kind between members of the proposed new "family tax unit"—husband, wife and dependent children—would be taxable. The exemption would apply, of course, to both gifts and inheritances.

Thus, there would be no tax at all when a man's estate passed to his widow or dependent children. Nor would there be any tax on any gift—regardless of size—he made while alive to his wife or a dependent child.

However, any gifts or bequests received from outside this family unit—including any made or willed by a man to children who are no longer dependent—would be taxable to the recipient, subject to a lifetime exemption of $5,000.

In defining the proposed family tax unit, the Commission said it should include unmarried children resident in Canada who are 21 or under, or over 21 and infirm. Actual support would not be the test of dependency. If a child under 21 went to work after school-leaving age, either he or his parents could choose whether he would be treated for tax purposes as a member of the family or as an individual, filing a separate tax return. Any child over 21 but under 25 could choose—if his parents agreed—to remain a member of the family while he completed his post-secondary education.

In addition to the $5,000 lifetime exemption, the Commission has proposed separate annual exemptions to relieve the administrative problem

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of taxing small gifts, such as Christmas presents.

For individuals, the annual exemption would be $250. For spouses who are members of a family unit, the exemption would be $250 each. For dependent children, it would be $100 each. Thus a husband, wife and two dependent children would have a family exemption of $700 a year.

"We believe that with these proposed exemptions a majority of people would never pay tax on gifts," the Commission said.

The present system of gift and death taxes—both federal and provincial—was severely criticized by the Commission. The system was bluntly labelled as an anachronism.

"Through the use of personal corporations, trusts and exemptions, it is possible to avoid and postpone substantial gift and death taxes," the Report said.

"These taxes almost certainly are not effective in breaking up pockets of wealth held by family dynasties, as is sometimes believed.

"They can, however, make it extremely difficult for a man to maintain his widow in the style she enjoyed when he was alive by substantially reducing the amount of property left for her support, even though he could not have accumulated the property without his wife's help."

In considering the new system, the Commission took into account the argument by some witnesses that taxes on estates influenced the sale of private businesses, particularly to non-residents. This was said to be due not to the tax itself, but to the fact that it would cause the property to be put on the market where other factors would lead to sale to non-residents.

However, after examining evidence submitted to the Commission on a confidential basis concerning the enforced sale of family businesses, the

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Commission said no clear conclusions could be reached. Some conspicuous cases—reported by the press—were studied. But in none of these cases did the impact of estate taxes "seem to have even a minor influence in favour of sale".

Another question examined by the Commission was whether taxes on the transfer of wealth ought to be reduced or eliminated to prevent Canadians from leaving the country to reduce the tax on their estates.

"We have rejected the argument that Canada should either lower some or all of its taxes to the level of its lowest tax 'competitor', or that Canada should turn itself into a tax haven of some sort. Both types of action can in the long run be self-defeating, are inequitable, and certainly should not be introduced by Canada."

If a Canadian left the country and transferred property to someone in Canada (other than a member of the family unit), the full Canadian tax would still apply. In the reverse situation, a withholding tax of 30 per cent would be applied to the gift or bequest made to a donee resident outside Canada.

The effects of these proposals—either in terms of tax rates or revenue—are difficult to determine accurately, the Commission said.

One major factor would be the liberal income-averaging provision recommended by the Commission so that large lump-sum payments, including gifts or bequests, would not result in a sudden, once-and-for-all tax increase. Such a gift could, in effect, be averaged over 10 years for tax purposes—five years back and five forward. Another major factor would be the proposed reduction in rates of income tax; the proposed top rate would be 50 per cent.

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For example, consider the position of a family with three dependent children, having an income of $10,000 and having used up the lifetime exemptions of $5,000 of both spouses. If this family received a gift of $25,000, its average rate of tax would be increased under the new system from 12 per cent (before the gift) to 14 per cent on total income including the gift, after averaging. Average rate of tax on the gift itself would be 22 per cent.

Comparisons are difficult. Under the present system of estate taxes, there is no tax on an estate which has a net value of $15,000 before personal deductions. On a $75,000 net value, the effective average tax rate would be 7 per cent, and on $300,000 it would be 20 per cent.

Thus, while small estates are not now subject to tax, the Commission's proposals would result in application of full personal income tax rates to most of any bequest from such an estate passing outside the family unit. If it stayed inside the family unit, such an estate would continue to be free of tax.

For larger estates, the question of whether the tax would increase or decrease would depend on the proportion of the total estate that passed outside the family unit. If all of it went outside, the tax would probably be higher than at present. If half the estate went outside the family unit, then the tax on transfers from most estates exceeding $250,000 would be lower than at present. If all of the estate was transferred to members of the same family unit, then tax would be eliminated.

There would be another major difference: proceeds of life insurance policies passed to beneficiaries outside the family unit would be taken into the recipient's income and taxed in that way. Only some of these proceeds are taxable now.

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"Thus, although the rate of tax on many gifts may decline, other gifts not now taxed would become subject to tax and therefore the total tax revenues from gifts should increase substantially," the Commission said.

In the case of property, when it is transferred—either on death or during the lifetime of the donor—there would be a deemed disposition at fair market value. Under the Commission's proposals for taxing property income, any accrued gain on the property would be taxable to the donor. The fair market value of the property would be taxable to the donee. Again, transfers within a family unit would be excluded from this provision.

"This treatment would ensure that property gains, whether realized or unrealized, would be taxed not later than the date on which the family unit was terminated," the Commission said. The unit would terminate for tax purposes if the spouses were divorced or legally separated, if they left Canada and had no resident dependent children, or on the death or remarriage of the surviving spouse, or—if both spouses were dead—when the children lost their dependent status.

Also taken into income—subject to the proposed exemptions—would be what the Commission describes as "transfers for inadequate consideration".

The Commission observed that ordinary gifts create no special taxation problems, but that it is easy to disguise a gift as a sale or other transfer where some payment or consideration is given in turn.

For example, a father might "sell" a new $4,000 car to his non-dependent son for $1. Legally, this is a sale. But for tax purposes under the proposed system it would be the equivalent of a $3,999 gift.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 7

MEDICAL EXPENSES

OTTAWA — A revision of the present system of deductions for medical expenses has been recommended by the Royal Commission on Taxation as an interim measure, pending medicare.

The Commission said that when comprehensive medicare—including drug and dental costs—becomes a reality, special tax provisions for medical expenses probably will be unnecessary.

As the law now stands, the taxpayer can claim as deduction from income his medical expenses in excess of 3 per cent of his total income. Benefit payments made under medical insurance plans (but not government-operated hospital insurance) are regarded as expenditures by the taxpayer, but his contributions to such plans are not deductible.

The taxpayer has the option of claiming the standard deduction of $100, which covers both medical expenses and charitable donations, without having to produce receipts.

If implemented, the Commission's recommendations would in effect substantially alter the definition of what is to be deductible.

The 3 per cent "floor" would remain. But only out-of-pocket medical expenses above that amount would be deductible from income in computing tax. This would mean that medical insurance premiums, or contributions to medical service plans, would be deductible. But expenses paid under such plans would not be deductible.

At the same time, the standard deduction would be eliminated. To the extent that it now applies also to charitable donations, the $100 deduction would be replaced by a smaller deduction applicable only to

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charitable donations.

The present treatment of government hospital insurance premiums would remain unchanged—that is, the premiums would be added to the incomes of employees when paid by an employer, and would not be deducted from income when paid by an individual or family. The Commission said this would be necessary to achieve consistency among taxpayers in all provinces.

The Commission said its recommendations would, without creating hardships, substantially reduce the number of taxpayers who now claim medical expense deductions in excess of the 3 per cent floor. Catastrophic medical expenses not covered by insurance would continue to be deducted.

"We think it will be recognized by most taxpayers that lower personal tax rates are preferable to standard deductions and to claims for medical expense that were not actually paid by the taxpayer," the Report said.

The Commission also recommended the repeal of the special $500 deductions from income which may be claimed by people over 70, and by the blind and disabled in certain circumstances. However, the recommendation is not as harsh as it might seem.

One section of the Income Tax Act provides for a special deduction from income of $500 that may be claimed by a taxpayer who:

1. Was at any time in the taxation year totally blind; or throughout the whole of the taxation year was necessarily confined to a bed or wheelchair, by reason of illness, injury or affliction; and

2. Made no claim for medical expenses on account of remuneration for an attendant or care in a nursing home, by reason of his blindness, illness or affliction.

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The Commission noted that only the taxpayer can claim the deduction. Thus it is not available with respect to a dependant.

Also, the taxpayer need be blind for only one day of the year to qualify for the whole deduction. But if he is injured on the second day of the year and confined to bed for the rest of the year, he does not qualify.

"The logic escapes us," said the Commission.

Since a deduction of actual expenses without a ceiling is permissible, the Commission said it is difficult to understand the need for the alternative treatment. Therefore it recommended repeal of the $500 deduction.

Another section of the Act allows a deduction of $500 for any taxpayer aged 70 or over.

The most obvious criticism of this provision is that it is no help at all to old people who have little or no income, and are truly in need, said the Commission.

In addition, information gathered by the Commission does not support the contention that the economic circumstances of the aged justify a blanket exemption. Studies have indicated that a significant proportion of elderly persons and couples are wealthy, and a disproportionately high percentage of the wealthy are old people.

"We appreciate that retired people often have to live on less income than they had before retirement, but this fact is properly recognized by graduated personal tax rates," the Commission said.

Granted, the elderly are more prone than younger people to unusual medical expenses. But the Commission said it believes that its recommendations on medical expenses would be adequate for the aged with

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taxable income.

"The basic problem, of course, is that an exemption is a very inadequate basis for a good welfare scheme," the Report said.

"The way to help the most underprivileged is by positive assistance, not by income tax concessions that fail to discriminate between the needy and the affluent, that give no benefit where it is needed, but do give a benefit where it is not needed."

The Commission said Canada's welfare legislation should be reviewed thoroughly. The special $500 deduction should be withdrawn.

At present, the Act also allows this deduction by those between 65 and 70 who are not getting a pension under the Old Age Security Act. But this provision was designed only to harmonize that Act with the tax law, and applies only to the 1966 to 1969 taxation years. The provision should remain in force, the Commission said, until a study of Canadian welfare legislation is carried out.

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 8

CHARITABLE DONATIONS

OTTAWA — New tax treatment for charities and charitable donations was recommended today in the Report of the Royal Commission on Taxation.

Its major proposals:

—Charities should keep their tax-exempt status. But they should be taxed on their business income and some of their investment income, if any. They should have to file annual returns of their gross receipts.

—Numbered donation receipts should be issued to charities in triplicate. The charity would keep one copy, the donor another, and the third would go to the tax authorities.

—Once these changes have been made, the tax-deductible limit on individual charitable donations should be raised to 15 per cent of personal income from the present 10 per cent. The 10 per cent limit for corporations would not be changed.

—Consideration should be given to allowing a 25 per cent tax credit for donations to political organizations of up to $50 a year for individuals, and $100 a year for families. Such donations are not deductible now.

This last point was made only as a suggestion.

It has been urged that such an approach would "help ensure that political organizations, so vital to the maintenance of the parliamentary system, have a broad base of financial support."

The issues go far beyond taxation, the Commission noted.

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"However, we feel that it deserves public discussion, and implementation if it is as desirable as we are inclined to believe."

In another area, the Commission recommended a new method of dealing with small charitable donations.

At present, individual taxpayers can claim an optional standard deduction of $100 a year to cover both medical expenses and charitable donations without providing receipts.

Recommendations by the Commission in the field of medical expenses would eliminate the optional deduction for those purposes.

However, the Commission proposes that a $50 optional standard deduction be retained for charitable donations. This would continue to eliminate the administrative difficulty of dealing with many small donations, each with its own receipt.

The new tax system, if implemented, would recognize certain "gifts in kind" for tax purposes--for example, gifts such as art objects to museums or galleries.

But the Commission balked at extending this idea to donations of such things as old clothes and old furniture to, say, charitable bazaars, because of the administrative problems that would be created.

Thus it recommended that donations in kind should be deductible only to the extent that they exceed $500 in value in any year.

Because property gains would be included in income under the Commission's recommendations, a valuation problem would arise. For example, if a person bought a $500 painting and sold it for $2,000, he would be taxed on the $1,500 gain.

However, if he donated the same painting to a museum, the

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taxpayer would still add the $1,500 gain to his income, but he could claim $1,500 as a charitable donation (the $2,000 value of the painting, minus the $500 exclusion for gifts in kind) if it did not exceed the limit on such donations by individuals of 15 per cent of income.

The Commission called for repeal of the existing tax law that gives tax-exempt status to a member of a religious order who has taken a vow of perpetual poverty, and has paid his income to his order.

However, it proposed tax relief to religious orders for postulants, or candidates for membership. The Commission recommended that one postulant under the age of 19 should be allowed as a dependant of each member of the religious order to which he seeks entrance, provided that parents or others are not also claiming the postulant as a dependant.

The Commission emphasized that there should not be any tax concessions that give one business a competitive advantage over another, and the present exemption of business income earned by charities could well be regarded as such an advantage.

Therefore they recommend that charitable organizations should continue to be exempt from tax only on contributions received and portfolio investment income (investment or business income from an incorporated or unincorporated business in which the charity has less than a 10 per cent interest).

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 9

DEFERRED INCOME

OTTAWA — Under the proposals of the Royal Commission on Taxation the tax benefits of Registered Retirement Income Plans would be increased, but the amounts accumulated by any one taxpayer would be tightened.

Some forms of non-registered plans—in particular, life insurance—would be taxed much more heavily than at present. The Commission's proposals would mean that life insurance would be taxed in the same way as other non-registered plans.

The Commission's many complex proposals in this already complicated field of taxation can be summed up this way:

Although the Commission's whole tax-reform package is based on taxing all net additions to a person's economic power—that is, his ability to buy goods and services—an important exception would be made on social grounds in the case of benefits that a person gradually built up by contributing to Registered Retirement Income Plans (which would include pension, retirement savings and profit-sharing plans).

Under the proposed system, as under the present system, benefits from these plans would be taxable when actually paid out but they would not be added to a person's taxable income as they accrued. This would amount to an extremely valuable postponement of income which, under the proposed tax system, would otherwise be taxable as it accrued.

For example, an individual who is subject to tax at a marginal rate of 30 per cent and who contributes $1,000 a year for 40 years to a registered plan, and who withdraws his benefits over 15 years would, under the Commission's proposals, assuming an investment of 5 per cent, have his

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retirement income increased by about 60 per cent over what could have been derived from a non-registered plan. His retirement income would be almost doubled if the yield was 7 per cent.

Not only would tax be deferred on the investment income earned, it would be deferred also on the contributions to the plan to the extent that they were deductible by the employer and the employee.

Under the proposed system, the deductible limits would be changed. The limit now is $1,500 a year for the individual's contribution (and a similar amount for his employer) in the case of registered pension plans. For registered savings plans the limit on the individual's contribution is 20 per cent of income up to $2,500 a year.

Under the Commission's proposal, contributions by the employer and the employee would be deductible until the beneficiary acquired a benefit equal to an annuity that paid $12,000 a year on retirement with a 10-year guarantee.

There would be no limit on the percentage of income that could be contributed to such plans. The limit on tax deferment would depend on the total value of the benefit, regardless of the extent to which it was derived from the employer, the employee or investment income.

The Commission believes that this procedure would end the tax avoidance opportunities that are available under the present system. Under the present system, the government has found it very difficult to develop regulations to limit the amount that companies can set aside for relatively high income employees.

In the case of life insurance—which now attracts about 30 per cent of the total personal savings of Canadians—a similar tax deferment

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would be available only if the policy was registered as a Registered Retirement Income Plan. Thus the accumulation of investment income through life insurance would no longer benefit from a general tax exemption.

Life insurance premiums, as at present, would not be deductible unless the policy was registered. However, it is proposed that policy dividends (which would be deductible in computing the insurer's tax liability) should be taxed in full to the beneficiary.

Except in the case of registered plans, investment income earned each year by the life insurance company on accumulated premium payments, and set aside in policy reserves for eventual payment of policyholder claims, should be allocated to each policyholder as taxable income, or made subject to a postponement fee or withholding tax, the Report added.

Eventually—but not immediately, because of the heavy impact of the other changes—so-called "mortality" gains and losses on life insurance should be included in computing income. "There can be no doubt that ability to pay is increased or reduced by this gain or loss", said the Commission.

Major changes would also be made in the way in which life insurance companies compute their income for tax purposes. Canadian companies presently pay little Canadian income tax, and foreign life insurance companies operating in Canada pay no Canadian income tax at all. The Commission recommends that these companies pay tax on the same basis as other corporations. In 1964 this would have increased their federal income taxes to about $77,000,000, compared to the approximate $2,000,000 they actually paid in that year.

The proceeds of life insurance policies are not taxed at present in Canada. But under the Commission's recommendations, the benefit either

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at maturity or death would be excluded from tax only if it went to the tax unit that paid the premiums. In other words, a death benefit would be taxed unless it went to a surviving spouse or to dependent children, or to someone else who took out the policy.

There would be one other major change from the present system under the Commission's proposals: both the life insurance companies and Registered Retirement Income Plans would be given—like other Canadian taxpayers--full credit for taxes paid by Canadian corporations in which they owned shares. At the present time taxpayers receiving insurance or pension benefits do <u>not</u> benefit from the dividend tax credit.

All told, there is little doubt that saving through life insurance would, in general, no longer benefit from the substantial tax advantages that it now enjoys, while saving through Registered Retirement Income Plans would become even more attractive than at present.

However, the Commission noted that their proposals would have relatively little effect on the benefits Canadians have presently accumulated in life insurance policies and pension plans.

Life insurance companies would have no difficulty in meeting their contractual liabilities and contracted premium rates would not be changed. However, it would be expected that the general rate of increase of policyholder dividends would not be as great under the Commission's proposals. In addition, the policyholder would have to pay some personal tax on the investment income allocated to him in future.

Benefits accumulated under present pension plans also would not be disturbed. However, in the case of plans that exceed the proposed new limit, no further investment income would be eligible for tax deferment.

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Under these proposals, the Commission emphasized, people would not be prevented from buying life insurance or contributing to pension plans, although the income tax concessions applicable to such payments would be limited in future. The overall effect would not be a reduction in personal savings in these forms, but rather some increase in total contractual savings.

In making these many recommendations, the Commission said its main objective was to check the unwarranted, extensive element of tax exemption or deferment now involved in many forms of contractual saving, and yet to retain some tax inducements on the social ground that individuals should be encouraged to save for retirement or hard times.

Moreover, the Commission said such tax concessions should be designed primarily for low and middle income groups where encouragement of saving is more socially desirable. And it said its proposals would have that result; they would be of relatively less importance for wealthy families, who would be prevented by the new upper limits from obtaining tax deferment on amounts of those required to provide the stipulated benefits.

Arguments that Canadians should save more to reduce the country's reliance on foreign capital were considered by the Commission. It said Canada's rate of saving is already high relative to other countries and "we can see no great merit" in providing tax incentives to raise it still further.

And even if it is decided as a matter of public policy that domestic saving should be increased, the Commission added, it should not be assumed that the best or fairest method is to increase personal saving. There are other ways—such as accelerated depreciation to boost corporate saving, or a government surplus combined with "easy" money to encourage investment.

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Following are some of the Commission's recommendations in more detail:

REGISTERED RETIREMENT INCOME PLANS

The Income Tax Act now gives varied tax treatment to registered pension plans, registered retirement savings plans, profit-sharing plans, and the various non-registered plans.

Under the Commission's recommendation, the same tax treatment would be accorded to all of these plans if they could meet certain conditions for registration--conditions reviewed in general terms in the Commission's Report, but which would be detailed in government regulations.

All plans which qualified would be taxed as "Registered Retirement Income Plans". This is how the system would work:

1. Contributions by employers and employees would be fully deductible until the maximum benefit (see 5, below) was achieved. There would be <u>no</u> annual limit. This would end the problem of how to limit past-service contributions and large employer contributions for employees, such as executives.

2. Income received by the administrator of the plan would be exempt from tax as long as the plan was registered. Where he invested these funds in a Canadian corporation, on dividends received he could claim for the plan a refund of the corporation income tax paid on the corporation's underlying earnings.

3. The tax concessions would, in principle, be limited to Canadian residents and taxpayers permitted to elect to be taxed as residents. Canadian residents who temporarily left the country but wanted to continue to be taxed as residents could so elect.

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4. To be registered, a plan should be administered by a separate trust or corporation in Canada.

5. The maximum allowable benefits would be the equivalent of a single life annuity, with a guaranteed term of 10 years, of $12,000 a year for an individual, payable from age 65. A family which includes a married couple would be allowed to make additional contributions to an individual plan or any second plan, to provide total retirement benefits equivalent to a joint and survivor life annuity of $12,000 a year for the two spouses without a guaranteed period, starting when the older spouse became 65 years old.

6. These allowable benefits for preferential tax treatment would be in addition to benefits from the Canada and Quebec Pension Plans. Thus total benefits from all registered plans could amount to over $13,000 a year, not including old age security pensions, without losing the tax concession.

7. All benefits received from registered plans would be included in full in the taxpayer's income, and would be taxed at full progressive rates in the year they were received. However, the Commission has also recommended liberal income-averaging provisions which would be available to soften the tax impact.

8. Lump-sum withdrawals from a pension plan now can be taxed at the taxpayer's average effective rate of tax over the previous three years. Under the new system, withdrawals before age 60 (except on death) would be subject to a special tax of 15 per cent in addition to the regular income tax, but this tax would be refundable if the withdrawal did not increase the taxpayer's income by more than, say, $7,000 in that year.

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9. In the case of existing plans that have accumulated assets in excess of those required to provide the new maximum benefit, contributions would no longer be deductible and future investment income would have to be included immediately in the beneficiary's income. However, the "excess" assets accumulated to date would be allowed to remain in the fund, and would not be brought into the beneficiary's income until they were distributed.

NON-REGISTERED PLANS

Contributions to non-registered plans would not be deductible. Any property income or employer contribution not attributed to an individual and included in his income, would be subject to a withholding tax of close to the top personal marginal rate of 50 per cent.

LIFE INSURANCE

The Commission said that in general, its proposed tax treatment of life insurance would be similar to that for the non-registered retirement income plans.

At present, premiums are not deductible. Nor are any parts of the proceeds of a policy taxable—not the return of premiums, or the income earned on investing those premiums (minus the company's expenses), or any mortality gain or loss realized as a result of actual events proving more favourable or less favourable than the conservative assumptions of the actuaries.

The Commission noted that these exclusions from taxable income are not the result of any specific legislative provision, but rather appear to result to a considerable extent from administrative practice.

However, life insurance looms large in the Canadian economy. In 1964, Canadians contributed over $1,300,000,000 in premiums, and received

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over $800,000,000 in policyholder dividends and other benefits. The insurers had a net investment income of about $600,000,000.

"Amounts of these magnitudes cannot be ignored when determining what is to be included in the tax base," the Commission said.

Taxation of policy dividends would pose few problems, the Commission said. The amount of these dividends already is reported annually to policyholders who are entitled to them. As in the case of interest paid or credited by other financial institutions, the policy dividends would be subject to a 15 per cent withholding tax.

However, in the case of the property income accrued as part of the policy reserves of the insurer, an allocation to individual policyholders would be a new administrative procedure.

Nevertheless, the reporting of such income to policyholders should be relatively straightforward, the Commission said, since at present well over half of the policies outstanding are "participating" policies—that is, the policyholders already receive annual notices of distributions.

In addition, determining the amount of investment income to be allocated to each policy would not be unduly difficult, since the insurer now must keep—as a basis for statutory valuations—detailed records of the reserves held under each kind of policy.

Under the Commission's proposals, any amount that the insurer failed to allocate to a policyholder would be subject to a substantial withholding tax. The insurer would have this tax refunded when the allocation was made.

Although this allocation would not provide the policyholder with cash to meet his tax liability—as in the case of a cash dividend from a

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corporation—the Commission said it did not believe the problem would be serious, because the amounts involved each year would usually be relatively small compared with the other income of the policyholder.

One exception would be made to the general requirement for allocations of this investment income. Some kinds of policies—including most term insurance—have relatively small reserves, and thus little investment income. In such cases, a detailed allocation may not be warranted. The insurer in this case should be given the option of paying a flat-rate tax of, say, 20 per cent on the investment income credited to reserves held for such policies.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 10

TRANSFER PAYMENTS

OTTAWA — A complete reappraisal of all government efforts to redistribute income through welfare and other transfer payments has been strongly recommended by the Royal Commission on Taxation.

Since such a study was beyond the Commission's own terms of reference, it had to accept—"reluctantly"—the existing system of many different programmes and a wide variety of complicated financing arrangements, even though the Commission found that much of this system involves transfers from those with small incomes to those with less income.

But the Commission did not accept what it described as the present "confusing and inconsistent" treatment of these programmes for tax purposes. Although admittedly dealing with only one side of the coin in the tax-expenditure system for redistributing income, the Commission made the following major proposal:

As part of overall tax reform based on equity and the taxation of comprehensive income, those receiving transfer payments—including family allowances, old age pensions, unemployment insurance, workmen's compensation and all other kinds of social assistance and relief—would be required to include these payments in their taxable income.

But at the same time, all specific contributions to these programmes would be deductible from total income.

The Commission said that before these proposals are implemented, the amounts of all government transfer payments should be reviewed to ensure that their inclusion in income for tax purposes does not result in hardships.

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The proposal for government transfer payments is consistent with the Commission's recommended tax treatment of other private "income maintenance" plans such as sickness and accident insurance, and group life insurance. For these plans as well, benefits would be taxable and contributions deductible.

Ordinarily, large lump sum payments from these public or private plans could mean a large increase in taxes. But to remove this potential hardship the Commission has also recommended liberal income-averaging provisions, under which these large additions to income in one year could be averaged back four years and forward almost indefinitely.

Following are the Commission's recommendations concerning some specific programmes:

Family Allowances

At present, these allowances—financed out of general government revenues—are not included in the recipients' incomes for tax purposes. Anyone who is entitled to receive them (whether he accepts them or not) must reduce the personal exemption for the child from \$550 to \$300.

Thus, those with low marginal rates of income tax receive more in family allowances than they lose through the reduction of the exemption. But the opposite is true for those with high marginal rates: they would be better off if no family allowances were paid, and the \$550 could be claimed.

Under the proposal, the family allowances would be included in taxable income. Exemptions for dependants would be abandoned, to be replaced by zero-rate brackets (i.e., no tax on the first \$1,000 of income for individuals and the first \$2,100 for families) and tax credits for dependent children, of \$100 for the first child and \$60 for each additional child.

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Because of these tax credits (worth more than the existing exemptions to a family with low income), the minimum income below which no income tax would be paid would be unaffected by the family allowance status of dependent children. Over this minimum, full rates of tax would apply to family allowance payments.

This system would also mean that no taxpayer could be made worse off because a dependant qualifies for a family allowance—as can happen now.

Old Age Security

Old age security payments already are taxable. The Commission's chief quarrel was with the method used to finance them.

At present, these pensions are paid out of "earmarked" taxes: a 4 per cent tax is added to the personal income tax rate (up to a defined limit), a 3 per cent tax is included in the rate of manufacturer's sales tax, and a 3 per cent tax is added to the federal corporation income tax rate.

Although the Commission said it "reluctantly accepted" present methods of financing transfer programmes, in this case it made an exception.

"There seems no legitimate reason to continue to earmark taxes to finance the old age security programme. To maintain the three separate levies seems to serve no useful purpose, and it is a source of inconvenience and needless complexity. The rate structure of the three relevant taxes should be adjusted accordingly.

"There also appears to be little if any merit in a continuation of the funding of the plan. We suggest that henceforth old age security pensions should be financed out of general revenues like family allowances."

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Unemployment Insurance

An employer now can deduct as a business expense his share of contributions to unemployment insurance for his employees. But the employee cannot deduct his contributions from his personal income. Neither the benefits nor the employer's contributions on behalf of employees are subject to personal income tax.

Under the proposed new system, benefits would be fully taxable in the hands of the person receiving them. But employees would be allowed to deduct their contributions from their other income, and the employer could continue to deduct his contributions.

"We believe that this is a fair treatment of unemployment insurance," the Commission said. "It brings into income only the net benefit as measured by the difference between what the employee put into the plan, either directly or indirectly, and what the employee takes out.

"Not to tax unemployment insurance benefits would bestow a tax advantage on the man who, despite the fact that he was unemployed for some time during the year, had a larger total income, including unemployment insurance benefits, than the man who worked full time for lower wages."

The Commission recognized that for some people—particularly those with substantial other income during the year—this system would reduce the net value of unemployment insurance benefits. "It may be necessary to increase gross unemployment insurance benefits to maintain their after-tax value for taxpayers in the lower income groups," the Report said.

Workmen's Compensation

These payments are not now taxable. They are financed under

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provincial plans through a pay-roll tax on employers, who can deduct their contributions as an expense of doing business. Covered employees make no contributions, and are not required to take the employers' contributions into their income for tax purposes.

These plans are designed to protect employers against costs resulting from successful damage claims by their employees, and to protect employees against losses resulting from injuries at work. Benefits include lump sums in case of death or permanent disability, income maintenance payments, and medical-hospital treatment.

"We are satisfied that the most logical tax treatment of workmen's compensation would be to continue to allow a business deduction for the employer contributions, but to tax employees on the receipt of all benefits at full personal rates.

"It might be argued that the contributions of employers should be added to the incomes of the employees, but we reject this because under our proposals they would be deductible by the employee in any event."

The Commission noted that most compensation awards are made to make up for lost income that would have been taxed, had it been received. If the payments are untaxed, the worker who receives them has an advantage over individuals who are not protected against accidents.

"Here, too, the level of the benefits should presumably be reconsidered by the provinces if this recommendation is accepted," the Commission added.

As part of its inquiry, the Commission made a detailed examination of how Canada's existing tax-expenditure system redistributes income.

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In the Commission's view, there was no question of whether this redistribution should take place. The only question was how much.

All told, the present tax system is regressive for low income individuals and families, the Commission found. This means that those with low incomes are paying a higher proportion of those incomes in all kinds of taxes than those with higher incomes.

On the other hand, low income individuals and families benefit far more than higher income persons from expenditures by the federal, provincial and municipal governments.

Combining the effects of both taxes and expenditures, the Commission found that the average family with an income of $10,000 or more makes a net contribution to government equal to about 9 per cent of its comprehensive income. The average family with income below $10,000 receives a net benefit of about 13 per cent of its comprehensive income.

Slightly more than half of the net benefit received by the family at the lower end of the scale comes from provincial and municipal governments. Slightly less than two thirds of the net contribution of those at the top of the income scale is made to the federal government.

The net effect of the whole fiscal system in Canada is a redistribution of income from those with incomes above $4,500 to $7,000, to those with incomes below that level.

This whole transfer-payment system needs study, the Report said.

The Commission's own recommendations were designed partly to achieve better income distribution, by reducing the effective rate of tax on those with low incomes.

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But this was only one side of the coin. A comprehensive system of transfer payments would ensure that the regressive taxes on low income people were invariably more than offset.

". . . there is much to be said for a complete reappraisal of what we in Canada are doing to redistribute income and how we are doing it," the Commission said. "We urge the federal government, with the participation of the provincial governments, to make a full and careful evaluation of the present transfer system. The study should have the widest possible terms of reference so that consideration could be given to all existing programmes."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 11

INCOME AVERAGING

OTTAWA — A new, more liberal system of income averaging available to everyone, has been recommended by the Royal Commission on Taxation.

This system would have two main features:

1. Anyone with large fluctuations in income would be permitted to average that income, for tax purposes, over a five-year period, provided the tax saving amounted to more than $50 (a provision to avoid numerous small claims).

2. In addition, those with large lump sum gains would be allowed to postpone the income tax on all or part of this money by depositing it in government-supervised, non-interest-bearing "Income Adjustment Accounts." These funds would not be taxed until withdrawn.

Besides providing tax relief for those whose incomes suddenly shoot up or down, the Commission's recommendations would—if implemented—have two important side effects:

—Since the provisions would not be related to the source of income or limited to working years only, a man whose income dropped sharply on retirement would likely be eligible for a large refund of taxes paid in his last few working years.

—On the death of the family breadwinner, the widow and dependent children (who would continue to be taxed on aggregate family income) would be able through averaging to obtain a tax rebate for earlier years of higher income.

"We do not wish to minimize the magnitude of the additional work that adoption of our proposal would create," the Commission said.

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"It would mean an increase in the work load of the administration and more record keeping by taxpayers. We are convinced, however, that the additional cost would be fully justified."

Moreover, the Commission said it believes that such an income-averaging system must be regarded as a vital part of the total tax-reform package it has recommended.

Without such a system, for example, the taxation of capital gains at full progressive rates would be "grossly unfair." The general averaging provision also would soften the tax impact of other large receipts that would be brought into taxable income—gifts and inheritances, damage payments, and property gains realized or deemed to have been realized on death or on giving up Canadian residence.

At present, averaging provisions are limited to farmers and fishermen, and authors.

A farmer or fisherman now is permitted to use a so-called "block-averaging" method. Briefly, this provides that his income in one year can be averaged with his income in the four immediately preceding years for which he has filed tax returns. Often he can get a substantial tax refund.

In the case of an author, the income spread-back period is related to the number of years it took him to complete the work, but cannot exceed three years. Thus, if he sells the copyright to a literary work which took him five years to complete, he can include one third of the proceeds in his income in the year of sale and one third in each of the two preceding years.

Why aren't other occupational groups allowed the same or similar privileges? The only reason the Commission could find is that they haven't applied enough pressure.

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xx pressure.

Yet fairness would require equal treatment for others with large income fluctuations—for example, actors, musicians, consulting engineers, architects, professional athletes, construction contractors, inventors, to name only a few.

The Income Tax Act now also provides averaging provisions for certain forms of income. Special rates of tax are applied to income from exercising stock options and to certain forms of lump sum payments, such as those out of a pension fund. Five-year averaging also is allowed on the "recapture" of depreciation when depreciable assets are sold by a business.

Under the Commission's recommendations, all of this piecemeal legislation would be repealed. Replacing it would be a general "block averaging", available to all resident Canadian taxpayers.

"To permit non-residents the relief contemplated for irregular income would raise serious administrative problems," the Commission said.

The averaging period would be five years. But this would be the maximum period; taxpayers would be allowed to average over shorter periods if they wished.

To keep administrative difficulties within bounds, the right to average would be available only when the income in the lowest year of the averaging period is less tnan 75 per cent of the income in the highest income year of the period. In addition, tax relief would be allowed only to the extent that the tax saving was more than $50.

Special averaging rate schedules would be used. This would mean that only one computation of a new tax payable would be necessary, instead of a new computation for each year averaged. Changes in tax rates would be reflected in these special schedules, making it unnecessary for the taxpayer to refer back to rates that existed in prior years.

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The start of the averaging period would be the year in which an individual began paying tax, or a family tax unit was formed. Thus, newly married couples would not be entitled to average their incomes to include years when they were single and taxed at higher rates.

Income Adjustment Accounts

"On equity grounds we think there is as much reason to allow a taxpayer to take his expected future income into account in determining his current tax liability as to allow him to take his past income into consideration," said the Commission.

Hence its recommendation for "Income Adjustment Accounts". These would be administered by the government. Deposits would be non-transferable, non-negotiable, and would not bear interest.

Deposits into these accounts made during the calendar year, and within 60 days of the end of the calendar year, would be deductible from income for that year for tax purposes.

Thus, by combining these special accounts with the block-averaging system, a person could average one year's income over a substantial period. Part of one year's income could be averaged back over four prior years, and another part could be deposited in one of the special accounts and averaged forward almost indefinitely.

On withdrawal of funds from these accounts, they would become taxable. Since the administrator of the accounts would report all withdrawals, the Commission said there should be no major risk of tax evasion. But to be sure, a withholding tax of 30 per cent would be applied to all withdrawals. The taxpayer, of course, would get credit for that tax when he filed his return.

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When a taxpayer emigrated, any balance that remained in his account would have to be brought into income for the last year in which he filed a tax return as a Canadian resident.

To limit the possibility of pyramiding tax liabilities at death, the Commission recommended that all individuals be required to withdraw all deposits before reaching age 60, and that families taxed as a unit be required to withdraw all deposits before the youngest member of the unit reached 60.

Other proposals by the Commission also would provide a type of income averaging.

For example, it has proposed a new limit on annual contributions to Registered Retirement Income Plans. The limit would be related to the amount accumulated in the plan at any one time, rather than—as at present—to the cash contribution to such a plan in any one year.

Thus, a person who received a relatively large sum in any one year could use this income to make a substantial contribution to a retirement plan. To the extent that these contributions had not purchased the maximum benefit, they would be deductible from other income in that year.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 12

BUSINESS INCOME

OTTAWA — The existing tax rate of 21 per cent on the first $35,000 of corporation income would be withdrawn under the recommendations of the Royal Commission on Taxation.

This would mean that all corporation income would initially be taxed at the one flat rate of 50 per cent. However, the proposed integration of corporation and personal income taxes would mean that ultimately all business income would be taxed at the personal rate of the Canadian corporate shareholder or business proprietor.

The business-expansion incentive of the existing low rate of corporation tax would be replaced by a new, more efficient incentive for new and small businesses in the form of rapid-depreciation allowances.

However, the Commission said it is not interested in any tax incentive that serves to perpetuate smallness and inefficiency in business. Therefore the new incentive, while available to all qualifying businesses for the first 10 years, would apply only to new businesses thereafter.

These recommendations are part of a long list of major changes in the way business income is treated for tax purposes. Among the other main proposals:

—The legislation would be amended to ensure that all types of revenues are taken into business income for tax purposes — including property gains, gifts, windfalls, and forgiveness or cancellation of debt.

—All expenditures reasonably related to the gaining or producing of income would be made deductible at some time. These would include the so-called "nothings", items that cannot now be deducted, such as payments

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for goodwill, the cost of obtaining or terminating some types of contracts, the costs of acquiring lists of customers, and certain costs of issuing securities.

—Less stringent provisions on the deduction, carry-forward and carry-back of business losses. Such losses now can be carried back one year and forward five years for deduction from business income only. Under the Commission's proposals they could be carried back two years and carried forward indefinitely for deduction from any income.

—More stringent limitations on losses created by deducting personal expenses.

—Tough, arbitrary rules to curb "expense account living".

—Greater reliance on accounting practices, and hence the elimination of many arbitrary rules, for example, in the tax treatment of reserves and in the valuation of inventories.

The existing lower rate of tax on the first $35,000 of corporate income was sharply criticized by the Commission.

This concessionary rate was first introduced in 1949 to encourage the growth of small businesses by leaving them with more funds for expansion. But as it stands the lower rate applies to all corporations, big and small, and regardless of whether they have trouble raising money in the capital markets.

The Commission estimated that the top combined rate of corporation and personal income tax on low income corporations has been about 35 per cent when the optimum statutory provisions for special rates of tax on distributions have been followed.

"This means that high income individuals, whose income should be

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taxed at high marginal rates, have been able to reduce substantially their effective marginal rates of tax by holding the shares of corporations taxed at the low corporate rate.

"Far from suffering 'double' taxation, these individuals have paid less tax on corporate source income than employees, proprietors, and partners have paid on incomes of the same size."

The Report said the low corporate rate has these major defects:

1. It does not apply to unincorporated businesses, which may have just as much or more difficulty in raising funds.

2. An income of $35,000 does not mean that the corporation is owned by low income shareholders, has few assets or small gross sales, or is new. Thus the incentive has little relation to the underlying problem—the shortage of funds for expansion due to imperfections in the capital market.

3. The incentive is inefficient because it has no regard for the magnitude of the corporation's total income. It thus reduces the average rate of tax for larger corporations, which have no difficulty raising capital in the market.

4. It also is inefficient because it applies whether the rate of return is high or low, or whether the assets or sales of the corporation are expanding or contracting. Since it has no time limit, there is no inducement for the corporation to expand.

5. By reducing the tax on low income corporations in perpetuity, it tends to cushion the market pressures on inefficient or declining firms.

6. The concession creates many potential avenues for abuse. To plug the worst loopholes, elaborate provisions have had to be enacted to

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prevent the break-up of large-income corporations into small-income companies that would each enjoy the lower rate.

However, the Commission said it believes that preferential tax treatment is one way to encourage the entry of new businesses into the Canadian economy. This in turn would increase competition, help introduce new products and techniques, and stimulate innovation in the large established firms.

Nevertheless, the Commission said it is important to distinguish between help for new businesses that are small because they are new, and help for small businesses as such.

"Our objective is to design a tax system that is neutral with respect to the size of business and to restrict any concessions to new business that, because the owners may be relatively unknown or have relatively few assets, are forced to begin in a small way. This is where the capital market imperfections are probably greatest..."

This latter problem is less serious now than in days past, the Commission noted. It added that its other tax reforms would in themselves provide an incentive to investment in new and small businesses, and also reduce the hardship that would otherwise be created by eliminating the lower rate for corporations.

Estimating the revenue impact of withdrawing the lower rate, the Commission emphasized that the integration proposal would mean that the shareholder would only be taxed at his personal marginal rate of tax. Thus a low income shareholder in a company now paying corporate tax at the reduced rate would not have his taxes greatly increased, and in fact could probably reduce his tax through the use of the accelerated-depreciation provision. On the

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other hand, upper income shareholders in low-tax-rate corporations would face a substantial tax increase.

The total tax levied on the corporate source income (including share gains) of residents would have been reduced by about $50,000,000 in 1964, if tax integration and the other proposed reforms had been in effect.

The integration scheme would not apply to non-residents. Their Canadian taxes on corporate source income would have been about $271,000,000 higher in that year, due mainly to withdrawal of special concessions from mining and petroleum companies and life insurance companies.

In setting up the new tax incentive for new and small businesses, the Commission said it was reluctant to add complex provisions that are inevitable when the tax system is used to achieve certain economic purposes, but felt it would be unwise not to do so in this case.

"We are concerned that if we did not propose a technique of assistance within the tax system, either our major reforms would be rejected because aid to new and small businesses outside the tax system might be thought to be impractical, or they would be implemented without the adoption of compensating policies outside the tax system, to the detriment of new and small businesses.

"We have decided that a concession to such businesses within the tax system that would assist in the financing of capital expenditures would reduce the major difficulty that confronts many of these businesses."

The specific concession:

Qualified businesses should be permitted to claim capital cost allowances up to the full actual capital costs in computing taxable income in any one year, or over a period of years, to a total value of $250,000,

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without regard to the maximum capital cost allowance rates set out in the regulations.

This concession would be available to all qualified businesses, including farming, regardless of the legal form under which the business was carried out—that is, corporation, trust, co-operative, partnership or proprietorship.

To qualify, the business would have to meet three tests for each year in which the accelerated capital cost allowances were claimed:

1. Gross revenues would have to be less than $10,000,000, and the assets—after capital cost allowances—of the business and of other businesses controlled by the same shareholders would have to be less than $1,000,000.

2. Canadian residents would have to hold at least 70 per cent of the beneficial interest in the business, defined as either the right to control, or to receive income.

3. At least 70 per cent of the beneficial interest should be held by one or more individuals, no one of whom (a) had a beneficial interest of more than 30 per cent in another qualified business, or (b) had within the previous 10 years had a beneficial interest of more than 30 per cent in another qualified business.

The administrative difficulties of a proposal of this nature would be limited by requiring eligible businesses to apply to the tax authorities for qualification. Capital costs incurred before qualification would not be deductible after qualification, except at normal capital cost allowance rates.

After a transitional period of 10 years, during which time all

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qualified businesses would have used up their accelerated depreciation or their qualifications would have expired, the concession would apply only to new businesses.

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 13

FINANCIAL INSTITUTIONS

OTTAWA — Canadian financial institutions should be taxed in the same way as other taxpayers. And the tax system should not be used to help ensure their solvency and liquidity; there is other legislation for that purpose.

These statements of principle have been developed by the Royal Commission on Taxation into a series of major recommendations that would affect the banks, life insurance companies, trust companies, mortgage loan companies, and finance and consumer loan companies.

The Commission's general proposals for the taxation of business income would apply to all of them. But the Commission has in addition made particular recommendations concerning financial institutions.

If implemented, these would result in all financial institutions being taxed under the same rules and procedures that apply to other businesses. Any competitive advantage that one kind of financial institution now holds over another because of the tax system would be removed.

Specifically, the proposals would mean:

—A substantial increase in income taxes paid by life insurance companies—about $75,000,000 in 1964 if the proposals had been applicable in that year. (Canadian life insurance companies now pay about $2,000,000 a year in income taxes; foreign life companies operating in Canada pay none at all.) The net increase would be less than this amount, as "integration" would result in tax refunds to many Canadian shareholders.

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—A sharp reduction in the amount of tax-free "inner reserves" allowed to the chartered banks as a special contingency reserve against possible losses (the existing ratio of these reserves to bank assets is more than 20 times the actual loss experience of the banks over the past 25 years).

—A similar reduction in the amount of special reserves allowed on mortgage loans, a proposal which would have its main impact on the trust companies and mortgage loan companies, which traditionally have invested heavily in mortgages.

The Commission said it expects that the tax increase for the life insurance companies would be reflected primarily in reduced allocations to actuarial and other reserves. There would be little if any impact on shareholders' dividends, but there could be some reduction in policyholder dividends. Premiums on policies issued in the future likely would increase.

Although their income taxes are relatively small or non-existent, the life insurance companies do pay provincial premium taxes. In 1964 these amounted to almost $10,000,000 for Canadian companies, and about $5,000,000 for foreign life insurance companies.

"Because the provinces would share in the tax revenues from life insurance profits, they might well decide to forgo the revenue from the tax on life insurance premiums", the Commission suggested, adding that if this is not done, then in equity a premium tax should be applied not only to life insurance but to all forms of contributions to saving plans. Premium taxes now are collected also from fire and casualty insurance companies, although they pay income taxes as well.

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Laying the basis for its recommendations, the Commission said that if the business income of financial institutions is treated for tax purposes like that of other businesses—and the Report recommends just that—then the only large remaining problem that applies particularly to them is estimating their losses that can be expected to occur on loans. The problem stems from the impossibility of determining accurately in advance what losses will occur on existing accounts and mortgages.

In principle, the Commission said, general or contingency reserves should not be recognized for tax purposes. Only those losses in asset values and those liabilities that can reasonably be expected to occur should be allowed.

But the Commission acknowledged that for administrative reasons it may be necessary to adopt rather arbitrary procedures in cases where it is extremely difficult to determine reasonable annual allowances for bad debts. The same administrative difficulty underlies the existence of arbitrary depreciation allowances.

In the case of chartered banks, their maximum reserves until recently were set by the Finance Minister under a formula that took into account for each year the change in the banks' average loss experience over the previous 25-year period. In 1963, the maximum reserve they could claim for tax purposes was 3.504 per cent of certain bank assets.

However, the Commission observed that while the banks had losses averaging 1.25 per cent of loans during one five-year period in the 1930's, their average annual loss experience was about one-seventh of 1 per cent of loans over the 25-year period from 1940 to 1964. Thus the reserve permitted by the Finance Minister was more than 20 times the average

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annual loss experience of the banks. That "would appear to be excessive", the Commission said.

Under the Commission's recommendations, there would be a substantial reduction in these inner reserves. The banks would be given up to 10 years to adjust gradually to new rates for these "allowances"— they would no longer be called "reserves". The rates "should reflect the expected losses, and should bear a reasonable relationship to the provisions claimed by competing institutions," the Report said.

Specifically, the Commission recommended that the banks be allowed a specific figure arrived at by valuing each loan, or be allowed to follow one of two other procedures:

1. They could claim a rate of "something less than" two per cent—approximately the same allowance now claimed by small loan companies—on balances of up to $100,000, and one half of one per cent for balances of between $100,000 and $500,000. On loans of over $500,000, expected losses would be determined by reviewing each loan in the same way as other taxpayers.

2. On loans under the $500,000 limit, the banks could instead choose an allowance of up to seven times the average loss experience for the previous five years.

These same provisions would apply to the Quebec Savings Banks. Unlike the chartered banks, the savings banks are at present permitted reserves up to a fixed percentage of 5 per cent of eligible assets.

The Commission also recommended a cut in the eligible assets for these allowances. Deleted would be loans to municipalities and school boards, call loans, guarantees and acceptances, letters of credit, foreign

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exchange provisions and any publicly traded securities not already ruled ineligible.

Similarly, the Commission described as "excessive" the existing arbitrary allowance of 3 per cent for mortgages. Though there are few published data on mortgage losses, a review of experience over the past two or three decades indicated average losses by the main lenders of much less than 1 per cent of loans.

In this case, the Report recommends an arbitrary allowance rate of close to 1 per cent for the better secured mortgages that are for less than 75 per cent of the fair market value of the real property, and something less than 2 per cent for other, riskier mortgages. Again, a $500,000 limit would apply; mortgages over that amount could be individually reviewed and assessed.

This arbitrary allowance would be allowed to all taxpayers holding mortgages, and not just to those who are in the mortgage business as at present.

The arbitrary percentages listed above would permit these institutions to continue to determine the tax provisions in an administratively simple fashion, but would prevent them from claiming deductions in excess of what is required to meet the losses that could reasonably be expected.

<u>Life Insurance Companies</u>

The present tax treatment of the life insurance companies "must be considered inappropriate and unsatisfactory", the Commission said.

In this case, the problem arises from estimating the companies' "actuarial reserves"—that is, the amounts set aside to meet future policy

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claims. This amount depends on assumptions based on mortality rates, future premiums, expenses and the expected yield from investing current reserve funds and expected premiums in long-term securities, mainly bonds and mortgages.

The assumptions followed are conservative, because of the uncertainty of long-term projections. The result is that surpluses are often created as the events prove more favourable than the assumptions made in setting premiums.

However, under the present law no income tax is paid on these surpluses until such time as they are formally allocated to shareholders' accounts—that is, allocated to the credit of shareholders. But in practice the stock companies allocate only enough surplus to cover dividend requirements and provide a small margin. In effect they pay income tax only on dividends paid.

Mutual life insurance companies are at present in effect exempt from tax. In a mutual company, the policyholders have bought out the shareholders. Under this procedure—designed to keep control of the companies in Canada—five large life insurance companies have "mutualized" since 1958. Since they have no shareholders' accounts, they pay no income tax.

Foreign life insurance companies operating in Canada are considered to have no shareholders' accounts in this country. Therefore they are not subject to income tax on the business income from their Canadian operations. They do, however, pay non-resident withholding taxes of 15 per cent on the portion of Canadian investment income which relates to assets exceeding 110 per cent of their Canadian liabilities.

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The overall result is that in 1964 the revenues of Canadian insurance companies exceeded expenditures—including policy dividends and a normal increase in actuarial reserves--by $90,000,000, and yet income taxes were paid on less than $5,000,000 of that amount. The income tax was about $2,000,000.

In comparison, Canadian life insurance companies, with about 30 per cent of their business placed abroad, paid $13,800,000 in income taxes to foreign governments, while the foreign companies in this country paid no income tax to Canada on a comparable amount of life insurance written in Canada.

The Commission recommended a major change in this "quite inadequate" system of taxation, by changing the assumed rate of investment yield used by the insurance companies in calculating their actuarial reserves.

At present, said the Commission, the typical assumption made by these companies is that their long-term investments will yield 3 to 3.5 per cent. Yet the 20-year moving average of the actual investment yields has not dropped below 4 per cent in the 1900's. The average yield for 1964 was almost 5.5 per cent. Since 1931, when the average yield fell below 6 per cent, there was only the seven-year period of 1945-51 when the average annual yield was under 4 per cent. That was in 1948, when it hit a low of 3.57 per cent. Since then, it has risen every year but one.

The Commission said it favours a new, arbitrary rate for investment yield—but strictly for administrative simplicity in determining income, and not as a means of building up contingency reserves. Circumstances now dictate a rate of more than 4 per cent, it said. The

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actual rate would be worked out in discussions between the government and representatives of the industry.

The Commission said the tax treatment should be the same for all life insurance companies—whether resident or foreign, or whether organized as stock or mutual companies or as fraternal benefit societies.

Since their business income would be taxed in the same way as that of other corporations, the life insurance companies resident in Canada would benefit from the integration system recommended by the Commission. But they also would be subject to tax on net gains and losses on investments.

Policy dividends would be deductible in computing the income of the paying company, and would be treated as income in the hands of the recipient. The dividends would be subject to a 15 per cent withholding tax.

Non-resident insurance companies would have their business income from Canadian branches taxed in the same way as the business income of Canadian companies. They would also be subject to the tax on branch income, which under the Commission's proposals would apply to all non-resident companies with branches in Canada.

These and other recommendations pertaining to the life insurance companies would increase their income tax base from about $4,000,000 in 1964 to about $154,000,000 for the same year. Their income taxes would rise from about $2,000,000 to $77,000,000. Of this $75,000,000 increase, about $42,000,000 would be attributable to residents and $33,000,000 to non-residents. The $42,000,000 increase for resident shareholders is the amount collected from the corporation and does not represent the net

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increase in tax—which would be somewhat lower, since integration would result in tax refunds for many resident shareholders.

One result of this higher taxation would likely be a reduction in the amount of funds available from the life insurance companies to help finance governments and businesses.

Also, if premiums on new policies had to be raised, or policy dividends reduced, life insurance as a form of saving could become relatively less attractive. The Commission said that conceivably total personal saving would be reduced, but it is more likely that the rate of personal saving would remain unchanged but more of it would be channelled through other institutions.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 14

MINING AND PETROLEUM

OTTAWA — Immediate cancellation of mining and petroleum depletion allowances and a phased withdrawal of the three-year tax exemption for new mines was recommended to the federal government today by the Royal Commission on Taxation.

The Commission said that these special tax privileges, which in 1964 reduced federal revenues by more than $150,000,000, have been unfair and inefficient and would be "unnecessary and unacceptable" in the face of other proposed reforms in the taxation of businesses generally.

The proposals would mean substantially higher taxes for some mining and petroleum companies. Initially the impact of the proposals would be reduced by the increased write-offs that would be available during the transitional period.

Hardest hit would be some of the largest companies which, the Commission said, have least needed the existing concessions and yet have benefited the most from them. Over recent years almost 85 per cent of the tax reductions involved in the concessions have gone to eight large mining and petroleum companies.

Because of the large degree of foreign ownership of Canadian extractive industries, the Commission estimated that non-residents would bear about 80 per cent of the tax increase. The balance of the tax increase at the corporate level would be attributable to residents, but would be partially offset by "income integration".

The Commission conceded that the existing concessions have encouraged Canadian mining and petroleum activities. As a result Canada

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has more investment and employment in these activities, has a better trade balance for those products, and knows more about her mineral and petroleum reserves, than would otherwise be the case.

But there is no presumption that all of this has had a beneficial effect on the overall economic well-being of Canadians, the Commission said. And even if it did, "the concessions were an unnecessarily costly method of achieving this result."

No adverse economic consequences of removing the concessions were anticipated by the Commission. It said the proposed tax reforms might shift some of the investment in mining and petroleum into other activities. However, the Report added that much of the foreign investment in this area appears to be insensitive to after-tax rates of return; it is more concerned with proving-up ore or petroleum reserves. If this is true, the net benefit to Canada could be increased by raising Canadian taxes on the income.

The Commission also considered whether the special tax concessions are required to increase Canadian mineral and oil and gas reserves. Its answer: present reserves are adequate for current requirements, and for most minerals the reserves are growing rather than declining relative to current output.

In the case of oil, the Commission noted that the output of conventional crude oil is still well below 50 per cent of capacity and the cost of exploring for it is rising steadily. In the near future, the Athabaska tar sands would become competitive with conventional crude, and Canadian oil reserves would be limitless. It would be perverse to grant generous tax concessions to encourage an unnecessary, high-cost search for conventional crude.

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If public policy dictates a need to stimulate mineral exploration, subsidies rather than tax concessions should be used, the Commission added. For example, the new government loan programme for northern exploration could be expanded; increased subsidies for transportation, communication and geological surveys could be made; or a subsidy equal to a fraction of additional exploration expenses could be provided.

Meanwhile, the Commission's recommendations would still give mining and petroleum companies preferential tax treatment in the form of write-offs for exploration and development costs. New companies without income could transfer this privilege to shareholders, as explained below.

The existing tax concessions:

1. In general, qualifying corporations can immediately claim the costs of exploration and development as deductions from income from any source. Any portion of these costs not absorbed against current income may be carried forward indefinitely. Expenditures on plant and equipment are not allowed as exploration and development costs since these assets are subject to regular capital cost allowance.

2. The income of new mines is exempt from tax for three years. Because the taxpayer may defer deduction of any capital cost allowance or development costs until after this period, income tax is unlikely to be paid for some additional years.

3. Those who operate oil or gas wells or mines (except gold and coal mines which get special allowances) can claim a depletion allowance equal to one third of their income from petroleum production or mining operations. In general, this reduces the effective rate of corporation tax by one third. Non-operators are entitled to a depletion allowance of

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25 per cent of their gross income from the mining or petroleum operation. In addition, shareholders are allowed to deduct 10, 15 or 20 per cent of the amount of dividends paid by certain corporations resident in Canada, if the corporations' income was derived directly or indirectly from the operation of a mine or oil or gas well.

The Commission recommended immediate withdrawal of all of the depletion allowances—for shareholders as well as operators and non-operators of mines or wells. The impact of this immediate change would be reduced to some extent by the special write-offs to be permitted in the transitional period.

However, it said that the three-year tax exemption should continue to apply to new mines brought into production during a five-year period, although for this period the amount of exempt income should be limited to $1,000,000 for any one mine.

Under the Commission's proposals, exploration costs—including the cost of depreciable assets that could be used only in connection with a specific exploration project—would be included in a separate capital cost allowance class which would be subject to immediate write-off.

Development costs would be included in the same capital cost allowance class for a transitional period of 5 to 10 years. Thereafter, they would be segregated in a separate class, subject to write-off at a rate of, say, 20 to 30 per cent a year on a diminishing-balance basis.

But to ensure that these benefits are available to new, independent companies without operating income (companies which benefit very little from the present concessions)—and to reduce any remaining capital market bias against risk taking in such new firms—the Commission recommended that they be allowed to extend this privilege to their shareholders.

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Under the latter proposal, investors would be allowed to write down immediately the cost basis of newly issued shares to the extent that the funds raised by the issue were to be spent on exploration and development. For the share purchaser, this write-down would produce a "loss" that could be deducted from other income.

This write-down would be allowed at the time of investment, even though the costs would not then have been incurred by the mining or petroleum company. When the company did incur the costs they would not, of course, be allowed to the company as a deduction from other income. As a result, corporation income tax would become payable at an earlier date. The tax authorities should establish controls to ensure that the company did in fact spend the money on exploration and development, the Commission said.

In the case of property costs, the Commission recommended a procedure that would continue to give the mining and petroleum companies more liberal treatment than other industries.

Under this system, the cost of properties would be capitalized in a separate capital cost allowance class for each property. The costs should then be amortized by the write-off of amounts related to the operating revenues from the same property. The allowance would be substantial—say, up to 50 per cent—in a transitional period, but thereafter would be set at 10 to 20 per cent of the operating revenue. If the property was disposed of, abandoned or became valueless, the unamortized balance would be written off. During a transitional period of, say, five years, an immediate write-off would be allowed for the cost of property rights acquired from a government.

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As an additional transitional measure, taxpayers in the mining and petroleum industries would be allowed to deduct, over three or five years, their formerly non-deductible costs of mining and petroleum properties, minus the amount of depletion they had claimed.

The tax exemption on the profits of prospectors and grubstakers would be withdrawn, though the Commission said it perhaps could be accomplished over some transitional period.

The Report said adoption of these recommendations would give mining and petroleum industries more favourable tax treatment than industry generally. And they would more than compensate for any possible capital market bias against risk taking.

For small and medium-sized companies, the proposals would be at least as beneficial as the existing tax concessions, the Commission said. But there is no doubt that the larger, integrated companies would pay higher taxes—how much higher would depend on each company's circumstances.

On the basis of 1964 tax returns by profitable companies, the Commission's proposed reforms would increase the total tax burden of mining companies (including prospecting and contract drilling) by $133,000,000 to $250,000,000. About $27,000,000 of this increase would be attributable to Canadians, the balance to non-residents.

For the oil and natural gas companies (including refineries) reporting profits in 1964, taxes would be increased from $47,000,000 to approximately $66,000,000. Approximately $4,000,000 of this increase would be attributable to residents, and the other $15,000,000 to non-residents.

The overall impact of the Commission's proposals on the after-tax

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rate of return from mining and petroleum companies is difficult to estimate because of many circumstances which vary widely from one company to another.

However, the Commission stated that, in general, adoption of the proposals would result in a reduction in the after-tax cash flow rate of return to both mining and petroleum companies with operating income.

For companies without operating income, who thus cannot now offset exploration and development expenses, the cash flow rate of return would, in general, be increased for the petroleum companies and very little changed for the mining companies.

For individual resident shareholders, the overall impact would be a combination of the effect of the proposed reforms applying to mining and petroleum companies and the recommendations for the full taxation of share gains, offset to a large extent by the integration of personal and corporation income taxes—that is, the provision to resident shareholders of full credit for taxes paid by the corporation.

However, the Commission acknowledged that a substantial proportion of resident shareholders of mining and petroleum corporations would be worse off. Non-resident shareholders would not benefit from integration; nor would they be subject to Canadian tax on their share gains.

"This is an unfortunate but inescapable result of removing an inefficient concession," the Commission observed. "Unless we are willing to accept the existing tax system as immutable, we must also accept undesired windfall gains and losses. They are the inescapable concomitants of change."

The revenue impact would be greater on the mining than on the petroleum industry.

Depletion claimed by the mining industry is more than double that

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of the petroleum industry, although in 1964 three petroleum companies were included in the eight companies that together accounted for about 85 per cent of the total amount of depletion claimed.

The largest mining companies would be hit the hardest by the withdrawal of the three-year tax exemption for new mines. In 1964, four mining companies accounted for more than three quarters of the exempt income under this provision.

The impact on the largest companies was estimated by the Commission by reviewing the past operating results of groups of producers.

For example, a review of four of the large iron ore mining companies, which together claimed $250,000,000 in exempt income under the three-year provision, indicated that under the Commission's proposed system they would on average still not pay any income tax until they had been producing for more than 10 years—about a year earlier than under the existing system.

In this case, the major difference is that the four companies would have had to claim all of their capital cost allowances in order to eliminate their taxable income.

Another example is that of the uranium mining companies. The major uranium producers up to 1964 had produced and sold over $1,000,000,000 worth of ore from mines that represented a capital investment of less than $250,000,000.

After retiring all debts and writing off the whole investment, they realized about $250,000,000, of which somewhat less than half was paid out in dividends. After deducting exempt income and depletion, the total income tax liability—including taxes paid by shareholders—was under

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$30,000,000, or about 10 per cent of the profits.

Under the Commission's proposals, the tax liability would have been about the same, but all of their capital cost allowances would have been claimed. Thus, their future taxes would be substantially higher "but this fact would not have precluded the development of any of these mines."

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 15

REVENUE EFFECTS

OTTAWA — A strong possibility of further reductions in tax rates beyond those immediately proposed is woven into the radical new tax system recommended by the Royal Commission on Taxation. The possibility arises this way:

In its terms of reference, the Commission was told that its proposals for tax reform had to be "consistent with the maintenance of a sufficient flow of revenue." Since "sufficient" was not defined, the Commission interpreted it to mean that any new tax system had to raise as much federal revenue as the existing tax structure.

Assuming that all Commission proposals had been implemented in full in 1964, the most recent year for which there is detailed data, this requirement would have been met and even exceeded. Total federal tax revenues in that year would have been $222,000,000 higher than they were.

However, for several reasons—mainly fairness to those involved—some of the major recommendations by the Commission could be implemented only gradually, over periods ranging from two to ten years. The net result would be a $1,000 million reduction in anticipated revenues over the whole transitional period, with most of this shortfall occurring in the first four or five years.

The result is that the Commission had to compromise slightly some of its tax-system objectives, and recommend rates of income and sales taxes that would cover that loss of revenue in the first few years under the new system, and still leave a reasonable margin for error in its revenue estimates.

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Obviously, once the transitional period ended, Ottawa's total tax revenues would be far beyond "sufficient" as the Commission interpreted it. The longer Parliament took to implement the transitional provisions, the higher would be the additional federal revenues.

"If government expenditures continued at a level that could be financed by revenue from current tax rates under the existing system, our proposals would permit significant future tax reductions," concluded the Commission.

The Report conceded that this approach ignores the expenditure side of the fiscal system.

"This condition should not be taken as indicating our views on the adequacy or inadequacy of the existing level of government expenditures, but only that, as a Royal Commission on Taxation, we were not invited to examine government expenditures.

"We are confident that our proposals would improve the equity of the Canadian tax system and would enable a given amount of revenue to be raised with wider public acceptance than under the existing system."

The following table shows (in millions of dollars) how 1964 federal tax revenues, adjusted to reflect tax changes enacted between 1964 and 1966, would have been affected by the full implementation of the Commission's recommendations.

	Current System	Proposed System	Change
Corporation income tax	1,941	2,473	532
Personal income tax	2,676	2,634	- 42
Sales and excise taxes	1,597	1,472	-125
Gift and estate taxes	143	—	-143
Totals	6,357	6,579	222

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These figures refer only to federal revenues—before tax abatements to the provinces—from taxes that are affected by the proposed reforms. Excluded are tariff and postal revenues, both raised by a form of "tax" which the Commission regarded as beyond the scope of its inquiry.

The $222,000,000 increase that would have occurred in 1964 masks one important shift in the overall tax burden:

Due mainly to the proposed withdrawal of special tax concessions to the mining and petroleum companies and some financial institutions, in which there is a large degree of foreign ownership, taxes on the Canadian corporate source income of non-residents would have been increased in 1964 by about $271,000,000.

Thus the total taxes imposed in that year on residents and on the unincorporated businesses of non-residents would have declined by some $49,000,000.

The latter decline of $49,000,000 can be broken down according to the revenue effects of each major tax reform. The results in round figures:

Revenue additions—$690,000,000 from increases in the personal income tax base, excluding the effects of the integration of corporation and personal income taxes and the taxation of share gains; $45,000,000 from taxing families as tax units.

Revenue declines—$300,000,000 from lower personal income tax rates; $50,000,000 from the integration of corporation and personal income taxes, taxation of share gains, and extension of the corporation tax credit to certain tax-exempt intermediaries; $150,000,000 from increased personal deductions; $100,000,000 from changes in concessionary allowances such as

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those for medical and educational expenses; $60,000,000 from more liberal income averaging; $125,000,000 due to lower sales and excise taxes.

Having opened the possibility of future tax reductions, the Commission—mindful that it had to sacrifice some of its objectives in setting tax rates high enough to overcome the transitional losses—suggested some ways in wnich reductions could be implemented:

—Reducing all marginal income tax rates in the same proportion.

—Further reducing the marginal income tax rates levied in the middle income brackets.

—Reducing marginal rates at the bottom and top of the income scale, while keeping middle income rates unchanged to make the rate schedules more consistent with ability-to-pay principles.

—Providing additional tax credits for individuals and families, to counter the regressiveness of sales and property taxes levied by all levels of government.

—Reducing the federal sales tax rate.

The Commission said the first two kinds of reduction would have the most favourable economic effect. The last two would improve the equity of the tax system. The third one would bear on both aspects of taxation.

"In any future tax reduction, the specific types of reductions chosen would have to reflect a decision as to the relative importance of further increases in the equity of the tax system or in incentives for the encouragement of investment and effort," said the Report.

"Other than to specify the range of alternatives consistent with the objectives specified . . . we do not make a recommendation as to which of the alternatives should be chosen."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 16

INCIDENCE

OTTAWA — Over 46 per cent of all taxpayers would have their "direct taxes" reduced by more than 15 per cent under the recommendations of the Royal Commission on Taxation.

The term "direct taxes" as used by the Commission includes personal income taxes, corporation income taxes, and gift and estate taxes.

Due to the kind of reforms proposed by the Commission—that is, the integration of personal and corporation income taxes, and elimination of the separate taxes on gifts and inheritances—it is necessary to lump all the direct taxes together to get any meaningful measure of their impact, compared with the existing system.

Broad effects of the Commission's proposals concerning direct taxes are shown in the following table:

	Number of Taxpayers for Whom Taxes Would be:		
Income	Decreased More Than 15%	Changed By Less Than 15%	Increased More Than 15%
Less than $5,000	2,713,328	1,685,259	370,048
$5,000 - 9,999	404,144	1,038,796	173,338
$10,000 - 14,999	5,269	125,901	37,960
$15,000 - 24,999	1,895	70,918	23,885
$25,000 or over	182	42,263	26,259
TOTALS	3,124,818	2,963,137	631,490

All told, more than 3,100,000 taxpayers would have direct taxes paid or attributed to them reduced by more than 15 per cent. Of these, almost 1,400,000 would pay no direct taxes under the new system, although

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direct taxes now are paid on income attributable to them.

In dollar terms, total federal taxes (including the sales tax) would have been increased by $222,000,000 in 1964 if the complete package of tax reforms recommended by the Commission had been in effect.

However, taxes on Canadian residents would have been reduced by $49,000,000. This would have resulted from a reduction in the revenue from the federal sales tax and certain excise taxes of $125,000,000, and an increase in total direct taxes of $76,000,000.

Non-residents with Canadian corporate source income would have had their Canadian taxes increased by some $271,000,000—not as any deliberate plan to tax them more heavily, but due mainly to the heavy concentration of their share ownership in large companies that would be significantly affected by the proposed removal of some major tax concessions:

1. Withdrawal of existing special tax concessions to the mining and petroleum industries, and to life insurance companies.

2. Withdrawal of the existing lower rate of 21 per cent on the first $35,000 of corporation income, with all corporations taxed in future at a single flat rate of 50 per cent.

For residents, the new "incidence" or burden of taxes under the Commission's proposed reforms would result from a complex interplay of many separate recommendations.

It is virtually impossible to show in either text or tables how each taxpayer would be affected, since the reforms would change not only <u>what</u> is taxed but how heavily it is taxed, and since individual circumstances vary so widely.

In general, however, the reduction in marginal rates of tax on

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personal income would result in substantial tax reductions for those who now rely almost entirely on employment or professional income.

But for those who have substantial investment income including capital gains—which would be added to their tax base under the new system—taxes would be substantially increased.

As for the sales tax, the recommendations of the Commission would result in a decline of roughly 12 per cent in the federal sales taxes paid by families with incomes between $2,000 and $10,000.

The change in average federal sales tax paid by families in different income classes is shown in this table:

Income	Average Sales Taxes Paid: Current	Average Sales Taxes Paid: Proposed	Average Change In Tax
Less than $2,000	$ 80	$ 78	$ -2
$2,000 - 2,999	144	131	-13
$3,000 - 3,999	212	187	-25
$4,000 - 4,999	252	218	-34
$5,000 - 6,999	347	303	-44
$7,000 - 9,999	503	435	-68
$10,000 and over	722	856	134
All classes	269	248	-21

It is difficult to measure with any precision the combined effect of changes in both sales and direct taxes recommended by the Commission.

However, the Report estimates that the net result would be a decline of roughly 10 per cent in total federal taxes collected from resident families with incomes of less than $5,000, and a decline of roughly 7 per cent for families with incomes between $5,000 and $10,000.

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On average, taxes collected by the federal government would be increased by 14 per cent for families with incomes above $10,000—but this average brings together a wide variety of changes in taxes for families in that income class.

Estimated changes in all federally collected taxes—before abatements to the provinces—under the present and proposed tax systems are shown in the following table:

Income Class	Average Current Tax: Direct Taxes	Sales Taxes	Total	Average Change In Taxes	Percentage Change
Less than $2,000	$ 26	$ 80	$ 106	$ -15	-15
$ 2,000 - 3,999	184	180	364	-40	-11
$ 4,000 - 4,999	352	252	604	-61	-10
$ 5,000 - 6,999	575	347	922	-69	- 8
$ 7,000 - 9,999	909	503	1,412	-81	- 6
$10,000 and over	5,178	722	5,900	807	14
All classes	540	269	809	- 7	- 1

To estimate the impact of the proposed direct taxes alone, the Commission ran data from actual 1964 returns for residents—the latest returns for which complete information was available—through a computer. The following table shows the average results, but it should be noted that such averages hide a great diversity in actual circumstances.

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In this table, "income" means comprehensive income as defined by the Commission.

Income Class	Number of Taxpayers In Class	Average Comprehensive Income	Percentage of Comprehensive Income Currently Assessed	Average Direct Taxes Current	Average Direct Taxes Proposed	Average Direct Taxes Percentage Change
		$	%	$	$	%
Less than $1,000	698,227	473	99	6	—	—
$ 1,000- 1,999	919,539	1,524	97	41	22	-46
2,000- 2,999	1,076,298	2,561	95	133	116	-13
3,000- 3,999	1,072,471	3,606	94	236	212	-10
4,000- 4,999	1,001,470	4,670	94	352	325	- 8
5,000- 5,999	722,461	5,718	94	498	474	- 5
6,000- 7,999	622,694	7,159	92	726	700	- 4
8,000- 9,999	231,123	9,349	89	1,147	1,140	0
10,000- 11,999	85,601	11,597	84	1,599	1,653	3
12,000- 14,999	83,529	14,125	81	2,152	2,240	4
15,000- 19,999	67,292	17,905	79	3,134	3,273	4
20,000- 24,999	29,406	23,337	78	4,643	4,792	3
25,000- 34,999	29,842	30,090	77	6,808	7,066	4
35,000- 49,999	18,663	43,142	74	11,081	12,185	10
50,000- 74,999	10,790	61,684	72	17,269	20,098	16
75,000- 99,999	3,710	88,291	71	26,635	32,237	21
100,000-149,999	3,113	120,305	70	37,458	48,129	28
150,000-199,999	1,119	173,398	69	56,076	74,392	33
200,000-299,999	834	243,899	68	80,914	108,908	33
300,000 or over	633	565,523	69	199,685	267,234	34
All classes	6,719,445	4,756	89	540	554	3

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 17

FEDERAL-PROVINCIAL

OTTAWA — A major overhaul of the federal-provincial tax structure would be needed to implement the sweeping tax-reform proposals submitted to the federal government today by the Royal Commission on Taxation.

The Commission's key recommendations in this area:

—Each level of government should be responsible for collecting and administering one major tax. Ottawa would collect its own and the provinces' income taxes. The provinces would collect their own sales taxes, where these exist, along with the federal sales tax that it is proposed should be applied at the retail level.

—To avoid an administrative mess and the "disastrous" degeneration of the tax system into eleven unco-ordinated and competitive tax systems, the two levels of government would have to agree to tax the same things—even if they did so at different rates of tax. Thus federal-provincial agreement would be desirable to establish the proposed new income and sales tax bases.

—Ottawa should have the dominant role with respect to personal and corporation income taxes. Existing income tax abatements to the provinces should not be increased. If Ottawa wished to give the provinces more tax room, it should do so by reducing its own rate of retail sales tax.

—Since the proposed comprehensive income tax base would take in most gifts and inheritances, the death taxes now imposed by the federal, Quebec, Ontario and British Columbia governments would be redundant and should be abolished.

—Since the provinces now are limited to direct taxes, a

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constitutional amendment would be necessary to allow them to impose a retail sales tax indirectly on retailers—"indirectly" in the sense that the tax would continue to be passed on to consumers. Existing provincial sales taxes are imposed directly on consumers, with merchants required to act as collection agents.

—The proposed integration of taxes on personal and corporate income, under which resident shareholders would get full credit for taxes paid on their behalf by the corporation, would make it highly desirable that the provinces withdraw from the corporation tax field altogether. The loss of provincial revenue could be made up through a share of federal corporation tax revenues, or a reduction in federal sales taxes to allow the provinces to increase their own sales tax rates.

—Should it prove impossible for Ottawa to gain exclusive use of the corporation income tax, the next best alternative would be for the federal government to provide full credit under the integration proposal for the federal corporation tax and a standard rate of provincial corporation tax.

The Commission noted that it was forced into the area of federal-provincial fiscal relations, because any change in the federal tax structure is tantamount to changing provincial tax systems.

It is extremely important that the two levels of government maintain a common income tax base, the Commission said. But that base should be widened to eliminate the inequities, anomalies and loopholes in the present system.

The new income tax base should be just as attractive to the provinces as to the federal government, the Commission noted. It would allow all governments to raise the same revenues with lower rates, or more

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revenues with the same rates.

Under existing federal-provincial tax arrangements, Canadians are paying a large part of their income taxes to their provincial governments. Consequently, the provinces could not be expected to accept meekly any unilateral federal changes in the tax base.

"It is obvious that federal-provincial agreement on substantive tax base changes is an inescapable necessity if a uniform base is to be maintained. And without a virtually uniform base there would be a real danger that the tax system would degenerate into an agglomeration of eleven unco-ordinated and competitive tax systems. This would be disastrous."

However, the Commission noted that it is under no illusion that it would be easy to achieve common tax bases, harmonized tax rates, and joint tax collection agreements.

"The drive for greater provincial autonomy is extraordinarily strong. The desire to have complete fiscal independence for each province as a matter of right, and as a tool for achieving provincial objectives, would make it difficult to persuade some of the provinces to work more closely with the federal government and other provincial governments in the tax field.

"The potential gains from success are so great, and the potential losses from failure so heavy, that we have no hesitation in urging the federal government to strive to attain these goals despite the serious obstacles that may be encountered."

The Commission's recommendations in this area were founded largely on five basic considerations:

1. Ottawa must continue to have the major voice in determining personal and corporation income tax bases. Consultation with the provinces

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is essential. But the federal government must be more than "a benevolent chairman of a committee of the provinces." This also is true--but to a lesser extent--of sales taxes.

2. "The federal government must ensure that the tax system does not become either a weapon with which the strong provinces tyrannize the weak provinces or a means of erecting barriers between provinces."

3. The federal government should continue to assume the major responsibility for redistribution of personal income, even though it has no constitutional obligation to do so. It has done this in the past: it has determined the progressiveness of the personal rate structure, and federal transfer payments have been largely responsible for offsetting regressive property and sales taxes.

4. The federal government should resist further increases in personal income tax abatements, in order to keep the personal income tax as its most effective tool for stabilizing the economy. This restriction should be relaxed only when a joint stabilization strategy is developed, and the provinces can play an effective stabilization role in co-operation with the federal government.

5. Over a period of time, the relative importance of sales and property taxes in the overall Canadian tax "mix" should gradually be reduced. This would improve the equity of the Canadian tax system, without hurting the country's international competitive position or the rate of economic growth.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 18

TAX ADMINISTRATION

OTTAWA — A completely new system of Canadian tax administration was urged today in the Report of the Royal Commission on Taxation.

Its main recommendations:

1. The functions of the Department of National Revenue should be taken over by an independent, non-political Board of Revenue Commissioners, reporting directly to Parliament through the Minister of Finance and having somewhat the same relation to the government as has the Bank of Canada.

2. A new Tax Court should be established to replace the existing Tax Appeal Board and possibly the judicial functions of the Tariff Board. The new Court would have separate divisions—an Income Tax Court, a Transactions Tax Court, and possibly a Customs Tariff Court. Appeals would be carried to the Exchequer Court.

3. Official information for taxpayers and the general public on the application of taxes should be substantially increased. The public should be given sufficient information on the operation of the tax authority so that "its efficiency and integrity may be subject to full examination."

4. A system of advance rulings on the tax consequences of intended transactions should be instituted. The new Board should be required by law to issue rulings directly to taxpayers at their request in the few cases where ministerial discretion is involved, and should be permitted and encouraged to issue rulings in other cases.

The Commission said that by placing tax collection under the proposed new Board, "impartiality would be assured and any attempt to

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exert political influence on the collecting authority would be negated."

However, the Commission emphasized that it was not implying through this recommendation that it had found any disturbing shortcomings in the Revenue Department. On the contrary, it found that departmental officials "are carrying out their duties in a dedicated and conscientious way."

"Rather, our views are based on a judgment that, whereas the political factor is an essential element in the policy-making function, it need have no role in the administrative side, and to the extent that it does operate, an uneven application of the law is likely to result.

"We are not unaware that the political influence will normally be a tempering one, easing the application of what might be a harsh provision when applied to individual cases.

"It is not our wish that harsh provisions cease to be tempered, but rather that the procedures by which this desirable result is achieved should operate openly and independently and in the full knowledge of all taxpayers.

"An administration that is basically free of political influence should raise morale among the people working in it."

The existing Revenue Department would form the nucleus of the proposed new Board.

Heading the Board would be a strong and respected Chairman, "a man of unique qualities whose status and salary should be at a level at least equal to the presidents of crown corporations or other important independent agencies of government."

The Board would have three panels of commissioners—Commissioners

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of Income Tax, Commissioners for Transactions Taxes (sales taxes), and Commissioners of Customs Tariff.

Of course, responsibility for actual tax policy would remain with the government and particularly the Finance Minister.

Dealing with tax adjudication, the Commission described as "not adequate" the existing administrative appeal procedures.

"To expedite tax settlements and avoid overloading the courts, it behooves the taxpayers, their representatives, and the administration to settle their differences without formal recourse to the courts where this can properly be done."

But just the opposite is happening now, the Commission said.

In the past five years, the ratio of formal Notices of Objection to examined returns that result in tax increases has more than doubled. This means that twice as many taxpayers who have differences with the Revenue Department are refusing to settle, short of Notice of Objection.

"In our opinion, this trend indicates a clear and positive need for a formal administrative appeal procedure prior to the Notice of Objection. We also feel that the administrative appeal procedures after Notice of Objection are not working as well as they might."

The Commission recommended a new decentralized system of administrative hearings. This would include a pre-assessment conference, a district conference, and a regional conference—all of them designed to help settle disputed tax assessments at an early stage without litigation.

Both the district and regional directors of the tax authority should be given the power to confirm, vary or vacate the tax assessment. This power would be withdrawn from the authority's head office, which

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should be concerned with administration and not get involved in particular disputes with taxpayers.

The Commission also seeks a more formal and public procedure for representations for tax changes.

At present, the Report said, the level of tax representation in Canada is very high—that is, its quality is good and the research underlying it usually is of high calibre.

"The raw material of public discussion is abundant, therefore, and what appears to be most conspicuously lacking is official machinery that will satisfy the public at large and the interests particularly concerned that consideration of tax changes is being carried out in the full knowledge of all the issues at stake."

There now is a danger that the government might be persuaded to make certain tax changes to suit the needs of one industry or section of the country, without being aware of its impact elsewhere, "simply because other taxpayers were in ignorance of the proposal and had no chance to make their position known."

Public examination of the proposal would reduce this possibility, the Commission said. It recommended that the proposed new Board of Revenue Commissioners hold public hearings on tax problems and on proposed tax regulations.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 19

CANADA-UNITED STATES TAX DIFFERENCES

OTTAWA — The gap between Canadian and United States income taxes would in most cases be greatly narrowed—and in some cases eliminated—under the proposals of the Royal Commission on Taxation.

The Commission estimated that for families with two children and incomes above $6,500, income taxes in Canada now are substantially higher than in the United States. This is often regarded as one of the incentives for Canadian emigration to the United States.

Even under the proposed new tax system some Canadians would still pay higher taxes than if they lived in the United States. But the difference would be so much smaller than at present that the Commission believes it could no longer be counted as a significant factor in the "brain drain".

For example, for a family without dependants with employment or professional income of $10,000 a year, Canadian income taxes now are about $195 higher than they would be in the United States. Under the proposed new tax system they would be only $7 higher.

A family with two children and an income of $5,000 now pays about $26 more in income taxes in Canada than in the United States. If the Commission's reforms are implemented, income taxes for the same family would be $33 less in Canada than in the United States.

These improvements result mainly from the substantial reduction in the rates of personal income tax recommended by the Commission.

However, at the same time the Commission proposes major changes in the definition of "income" for tax purposes, including the addition of all capital gains. For those with substantial investment income this would more than offset the lower rates of tax, and they would pay higher taxes.

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Thus the Commission's Canada-United States tax comparisons under the existing and proposed systems apply strictly to those with only employment or professional income. This is the group that the Commission believes has been taxed too heavily in the past.

The following table shows the differences between average Canadian and average United States personal income taxes under the present and proposed systems (the minus sign indicates Canadian taxes are below those in the United States):

	Unattached Individual		Family Without Dependant		Family—Two Children	
Income	Current	Proposed	Current	Proposed	Current	Proposed
$ 5,000	$ -36	$ -13	$ -58	$ -109	$ 26	$ -33
6,500	-15	30	-14	-75	108	27
8,000	18	57	42	-49	150	62
10,000	91	93	195	7	251	112
12,000	144	60	341	-3	418	177
15,000	242	-88	716	1	748	255
25,000	198	-1,230	2,202	-12	2,474	616
40,000	-510	-3,635	3,582	-480	4,780	1,170
70,000	-2,332	-9,150	4,724	-2,932	8,245	1,343
100,000	-4,343	-15,208	5,533	-6,120	12,426	1,873

As the table indicates, in the case of unattached individuals Canadian income taxes are already below those in the United States for the top and bottom income brackets. The Commission's recommendations would result in higher taxes on individuals with incomes up to about $8,000, but tax reductions in the middle and high income brackets.

The Commission said it recognizes that income tax differences are not the only factor influencing a person's decision to emigrate to the United States.

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Just as important, for many people, may be the persistently large difference between Canadian and United States mortgage interest rates. On a conventional home mortgage, these have been about 20 per cent higher in Canada than in the United States in recent years.

Other taxes besides income taxes are higher in Canada than in the United States. The average rate of sales tax in Canada is roughly double the average rate in the United States, and in fact is one of the highest rates in the world.

However, the Commission said that differences in overall tax burdens are probably not as important in the "brain drain" as differences in salaries, working conditions, and living costs.

"For reasons that need not concern us here, Canadian employers generally do not offer competitive salaries and frequently have not been able to offer work as interesting as that offered by United States employers."

Nevertheless, the Commission said it was concerned that there should be no major tax incentives for this emigration. It noted that for many Canadian workers, the market for their services is continental, not just Canadian.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 20

RESEARCH AND DEVELOPMENT

OTTAWA — The Government's move toward grants, and away from special tax incentives, to encourage research and development in Canada has been welcomed by the Royal Commission on Taxation.

However, in its Report published today the Commission questioned whether either scheme is really effective. It suggested that unless somebody can demonstrate that these methods are more efficient, the Government should place greater reliance on two existing programmes:

1. The Industrial Research Assistance Program, administered by the National Research Council, which pays the cost of personnel engaged in scientific research—people whose qualifications are under review by somebody knowledgeable in this field.

2. The Program for the Advancement of Industrial Technology, administered by the Department of Industry, which pays half the non-capital costs of developing products or processes that involve new technology—or new applications of existing technology—with industrial applications.

However, the Commission said it favours keeping the existing tax provision for immediate write-off of current and capital expenditures on research and development, as well as deductibility of expenses (other than capital) for research conducted outside Canada.

Meanwhile, the Report said there is an urgent need for an appraisal of the returns that are likely to result from different kinds of research and development expenditures.

The Commission said that so little is known about the kinds of research that are required, and who should do it, that it is dangerous to

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take a firm stand on how to encourage research and development.

"Canada desperately needs some research on research."

Admittedly, it would be very difficult to appraise the returns to "basic" research versus "development" research, and of research done by institutions as against that of private industrial firms. But unless some view of this matter is taken, there could be waste and confusion.

Establishment of a secretariat in the Privy Council office to co-ordinate federal research programmes was a move in the right direction. But it also would be necessary to do research on research if the co-ordination is to accomplish more than consistency.

"Consistent error is no improvement over confusion," the Commission said.

The Report said it would be a great mistake to do anything that would jeopardize the flow of scientific and technical information into Canada from the United States or elsewhere.

But one problem might arise from this dependence on foreign research: it is possible that borrowed U.S. technology carries with it products and techniques not well suited to Canada's markets.

Obviously, this question also would be difficult to assess.

Even if large foreign companies could be persuaded to do a greater part of their research in Canada, it would not necessarily follow that the research done here would be any different from that done abroad, if the instructions still come from the foreign company.

"This brings us to what we think is the heart of the matter," said the Commission. " . . . we doubt whether broad incentives that apply without qualification to 'research and development' can be effective."

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The tax incentive programme allows an extra deduction (beyond immediate write-offs) of 50 per cent of the increase in research and development expenditures over those for the year ended prior to April 11, 1962.

The government intends to modify the incentive. The modifications include:

—A cash grant or credit against tax liabilities of 25 per cent of research expenditures that will provide an equal incentive to all businesses, regardless of their tax position.

—Application of this incentive to all capital expenditures and to current research expenditures in excess of the preceding three-year average.

—A review by the Department of Industry, which would administer the new programme, to ensure that the expenditures would be likely to benefit Canada.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 21

AREA INCENTIVES

OTTAWA — Tax incentives for the designated areas should be repealed and replaced by subsidies, the Royal Commission on Taxation said today.

"We cannot be sure that the subsidies will be effective, but they should be more effective than the tax incentives per dollar of revenue forgone or expenditure incurred," said the Report.

Meanwhile, the Commission urged that a full-scale research programme be undertaken as soon as possible on the problems of regional economic development.

"Until we know much more about the process of regional growth, government programmes can be little more than shots in the dark that indicate good intentions."

The tax incentives were launched in 1963. They provide for a three-year exemption from income tax, plus accelerated depreciation, for new manufacturing or processing businesses establishing themselves in the depressed, designated areas.

In 1965, the federal government introduced the Area Development Incentives Act under which the Minister of Industry is empowered to make subsidies to firms establishing new facilities or expanding existing facilities in designated areas. These non-taxable subsidies are paid under a formula based on approved capital costs.

The Commission said it welcomes this move to subsidies. It recommended that the subsidy programme be expanded.

A major advantage of subsidies is that their cost is known, and

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can be matched against benefits.

Tax incentives, on the other hand, are impossible to measure for real cost or effectiveness. Since the present incentives allow a business to postpone any deduction of capital cost allowances until after the three-year exempt period, they provide a much larger concession than is immediately apparent.

Given the present knowledge of regional growth processes, even the subsidies may often be a shot in the dark, the Report indicated.

The Commission said it is doubtful whether subsidies that fail to take into account the specific needs of specific areas will lead to an efficient allocation of capital among the areas.

However, the unselective nature of such incentives would be offset to some extent by other regional-development programmes aimed at better education, roads and cheaper power, and geographic focal points for development to help realize economies of scale.

"We are also aware that highly selective subsidies involve a risk of serious error, unless those who allocate the funds are extremely knowledgeable," said the Report.

"The state of knowledge about regional development is still so fragmentary that heavy reliance on government planning for industrial development within regions is perhaps premature.

"Selective subsidies to industry also have the disadvantage, at least to many people, that they require a high degree of government intervention in business decision making.

"We strongly recommend that a full-scale research programme on the problems of regional economic development be undertaken with all

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speed. The problem is of great importance and complexity. Every effort should be made at an early date to assess the effectiveness of the new programmes."

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 22

CO-OPERATIVES AND OTHER MUTUAL ORGANIZATIONS

OTTAWA -- Members of consumer co-operatives, credit unions and caisses populaires would be taxed on the patronage dividends or interest rebates paid or credited to them, under the recommendations of the Royal Commission on Taxation.

The organizations themselves—that is, the co-ops or credit unions—also would be taxed at the proposed new flat corporate rate of 50 per cent of taxable income. But in computing taxable income, they would be able to deduct the dividends or rebates to the extent that half were paid in cash.

At first blush, this may seem like corporation tax treatment for co-ops. But in fact the situation under the overall tax reform recommended by the Commission would be just the opposite: corporations would be treated more like co-ops.

As the law now stands, co-ops are taxed on their unallocated income—that is, they are able to deduct all or most of their patronage dividends. These dividends are taxable in the hands of the recipient, except in the case of co-ops providing goods and services to consumers.

If corporations were treated in the same way for tax purposes, it would mean they would be taxed on whatever was left of their profits after paying dividends to shareholders. But since this is not the case, of course, the co-ops have a distinct advantage over corporations.

"Adoption of our integration proposal would go a long way toward removing this disparity by bringing the treatment of corporations closer to the treatment that has heretofore been accorded co-operatives," the Commission said.

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Under this proposal, taxes would be collected from all corporations at one rate of 50 per cent of profits. Shareholders would take their share of these profits—whether paid or allocated to them—into their taxable income, but would be given full credit for the taxes already collected from the corporation.

Thus, in effect the income of an organization--regardless of the form it takes, corporation or co-operative—would be taxable only once, and at the personal income tax rate that applies to its owners, whether shareholders or co-op members. Both would carry the same tax burden.

"This is eminently desirable," the Commission commented. It is in line with the Commission's philosophy--underlying many of its specific recommendations--that for fairness, people should be taxed on net additions to their purchasing power, regardless of how they acquire them.

But one problem area remains. The payment of tax on corporate income before the deduction of shareholders' dividends reduces the amount of cash that can be retained by the corporation. If co-ops were not to have a cash-flow advantage over corporations, it would be necessary to require that a minimum proportion of co-op distributions be in cash.

Accordingly, the Commission recommended:

1. For co-operatives, patronage dividends would be deductible in computing taxable income only to the extent that half of them had been paid unconditionally in cash—that is, the deductible amount of such dividends could not exceed twice the total amount paid out in cash.

2. Similarly, credit unions and caisses populaires in computing their taxable income would be able to deduct interest and dividends paid and credited to members, and interest rebates made on loans, to the extent

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that half the amounts were paid unconditionally in cash.

In both cases, to ensure that taxpayers report these distributions as income, a withholding tax of 15 per cent would be paid by the co-op or credit union on its total distributions. The 15 per cent would be deducted from the portion paid in cash.

Taxpayers, of course, would claim credit for this tax in filing their own income tax returns. If their effective rate of tax was less than 15 per cent, they would claim a refund.

The three-year exemption from tax for new co-operatives would be discontinued. But at the same time new co-ops would be eligible for the Commission's recommended incentives for all new businesses, in the form of rapid-depreciation provisions.

In addition, the Commission said it will be necessary to prevent co-ops and credit unions from passing out tax-free to their members property income and business income from activities that are not related to their primary function as mutual organizations. This would include income from doing business with non-members, and the earning of interest, dividends from other organizations, and rent.

To prevent this income from being used to reduce the cost of goods and services supplied to members of the co-ops, the Commission recommended that losses from carrying on the primary functions of these organizations should not be deductible from the income from their unrelated activities.

Thus, losses arising from the business activity of providing consumer goods and services would only be eligible to be carried back two years, and carried forward indefinitely for deduction from previous or future income from the same activity.

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Tax treatment of co-ops and credit unions was one of the most contentious issues raised during the Commission's public hearings.

Strong opinions were expressed on three basic questions: Does a co-operative activity create income? If so, how is it measured? Is it income of the co-ops, of the members, or of both?

Many contended that a co-op was organized to carry out specific activities on behalf of its members, and any margin resulting from its operations was merely a saving for its members for whom it was acting as an agent. Others argued that co-ops carry on business in the same fashion as business organizations and that their motive is economic gain.

"In our view, the important point is that, if the economic position of the members is improved as a result of the activity, the economic gain is a proper subject for taxation," concluded the Commission.

Measuring co-op income poses a problem. Since the owners are also the customers, they are indifferent about whether their economic reward is distributed in the form of dividends or rebates, or as price reductions. Thus, while theoretically there is a return on capital and managerial ability, it cannot be said with exactness how great it is.

On the other hand, most co-ops follow market prices where they can be determined, to avoid price wars and the danger of forecasting their margins incorrectly. Any attempt at "pricing out"—that is, adjusting prices to produce a break-even result at the end of the year—could affect their financial stability.

"When a co-operative prices its goods and services according to the market, the surplus it reports before distributing patronage dividends should represent a reasonable measurement of the income produced in the operation," said the Commission.

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But whose income is it—the co-ops' or their members'?

Under the existing tax system, this is an important question. But under the new system recommended by the Commission, it wouldn't really matter.

The Commission is proposing that all income flows would be taxed in the same manner regardless of wnether they came through partnerships, ordinary corporations, or other organizations. The question of how much income was the income of the organization would be of minor importance.

"In our view," the Commission said, "the income of the co-operative should ultimately be taxed at the individual rates of the members in the same manner as the income of ordinary corporations should ultimately be taxed at the individual rates of the corporate snareholders."

Private Club and Similar Organizations

Organizations of this general type are basically a non-dividend paying form of consumer co-operative, and should be taxed in the same general way as co-operatives. Thus, profits from business activities unrelated to the primary activity of the organization should be taxed, either to the club or to the member if they are distributed. Under the Commission's proposals this would mean that the property income of these organizations would be taxed, but that any profit or loss on the basic operations of the clubs with members would be exempt from tax.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 23

FARMING, FISHING, FORESTRY, CONSTRUCTION

OTTAWA — The Royal Commission on Taxation has recommended changes in the way income is computed for tax purposes in the fields of farming, fishing, forestry and construction.

However, these proposed changes in themselves would have relatively minor effects on the overall income tax position of the people involved.

In almost every case the Commission's recommendations are designed primarily to ensure that the measurement of income from these ventures is brought closer into line with accepted accounting principles in business generally.

Following are the specific recommendations in each field:

Farming

As the law now stands, farmers (and those in professions) can report their income on a cash basis instead of the accrual basis used in other businesses. Farmers are allowed to average their income over five-year periods. Other concessions include the "basic herd" principle, under which the cost of acquiring a certain number of animals is not deductible and the proceeds from selling them are not taxable.

"In general, we have found that many of the special tax provisions and practices are no longer appropriate," the Commission said.

"Because of the changing nature of the industry, farmers, or at least those with larger incomes, should now be able to report income on a basis similar to that followed by other small businessmen.

"Special tax treatment intended to meet the special circumstances of agriculture has in turn led to significant inequities, anomalies and

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loopholes, and to administrative difficulties.

The Commission recommended that both the cash basis of computing farming income, and the basic herd principle, be discontinued.

However, until farmers and other small businesses get help to put their records in order, the requirement to compute income on the accrual basis should not apply where gross revenue was less than, say, $10,000 a year. And where the cash basis could be continued, so could the basic herd provision.

For those over the $10,000 line, shifting to the accrual basis would involve immediate imposition of tax on the value of inventories and accounts receivable, less accounts payable. Although this would result only in the immediate collection of tax that would be paid eventually anyway, it could result in severe hardships in some cases.

Therefore the Commission recommended that the cost basis of the farm land at the transition date—which would be its fair market value—should be reduced by the amount of the net adjustment needed to put the farm business on the accrual basis. In effect, this would mean that the income added by moving to the accrual basis would not be taxed until the farm was disposed of.

In selling a farm, the owner would be subject to tax on the capital gain exceeding the proposed lifetime exemption of $25,000.

The existing provisions concerning the sale of farm property to a child also would be changed under the Commission's recommendations.

At present, a general provision of the Income Tax Act says that on a sale of depreciable property between related persons, the depreciable amount cannot be higher than the capital cost to the vendor. But there is

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an exemption for farming and fishing. If a farmer sells depreciable farm property to his child, the price paid—provided it does not exceed fair market value—will be recognized as the capital cost to the child, even though the price may be over the original cost to the parent and would thereby create a non-taxable gain to the parent.

Under the overall tax system proposed by the Commission, all proceeds on the disposal of depreciable assets would be taken into income for tax purposes. Therefore the Commission has recommended that the fair-market-value rule should be extended to apply to depreciable assets transferred between related persons. This rule would also apply to depreciable farm property.

"It may be contended that this would impose hardship because it would force a farmer to sell his property to his child at nothing less than fair market value," said the Commission. "However, not only is this treatment the same as that proposed for property generally and for other kinds of business but, in addition, the farmer would be eligible for the lifetime exclusion of $25,000 for realized gains on residential and farm property . . .

"Thus, the owner of even a moderately sized farm would normally be exempt from tax on the disposition of his farm, and the purchaser, for example, his son, would be able to claim depreciation on the fair market value of the property acquired. The only change in most cases in which a farmer transferred a farm to his son would be the requirement to recapture depreciation."

If a farmer wanted to transfer a farm to his child for less than fair market value, the Commission said, this should be recognized for what

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it is—namely, a gift. But under the proposed rules for gifts, a transfer of farm property for less than market value would be exempt from tax to the extent of $5,000 each for the son and his wife.

The Commission also recommended that the provision for straight-line depreciation of farm assets be discontinued. This is now the only exception (other than that for fishermen) to the diminishing-balance method of depreciation, adopted in Canada in 1949, and the Commission said it is no longer warranted—if indeed it ever was.

The existing income-averaging provisions designed especially for farmers would become unnecessary; the Commission is proposing averaging provisions, much the same as those now provided for farmers, that would apply to all taxpayers.

In addition, the Commission said the present specific restriction on the deduction of losses from hobby farming should be replaced by a general provision designed to prohibit the deduction from other income of losses incurred (after the first three years of loss) by any business which consistently operated at a loss. Such losses should, however, be carried forward indefinitely for deduction from profits from the hobby farm.

The Commission also said the present administrative treatment of farm home expenses is unduly favourable to the taxpayer, and should be altered.

The deductibility of farm home expenses now is governed by general provisions of the Income Tax Act, allowing a deduction for expenses incurred for the purpose of earning income, if these do not represent personal or living expenses.

In practice, the tax authorities have been allowing the total

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cost of light, power, taxes, telephone and fire insurance. If the house is more luxurious than normal, the deduction permitted may be lower.

"It appears to us that this practice is not in accordance with the provisions of the legislation . . . and we recommend that it be brought into line with that accorded other taxpayers such as doctors and storekeepers who use certain facilities both for business and personal purposes.

"If the determination of a reasonable portion in each case is too difficult to administer, a small percentage of all farm home expenses might be universally allowed, additional amounts being permitted only where supporting evidence was given to justify it."

Fishing

Since the fishing industry has many of the characteristics of farming, including the prevalence of many small operators, it is subject in many instances to similar tax provisions.

The Commission recommended that its proposals on the method of depreciation, income averaging, and the sale of depreciable property to a child, should apply to the fishing industry as well as to agriculture.

Forestry

One of the major recommendations of the Commission in the field of forestry is that provincial logging taxes should no longer be claimed as a tax credit in computing federal tax, but should be allowed as a deduction from other income.

Reforestation costs should be allowed as a current expense, even though the resulting revenue may not appear for many years. At present, these costs are allowed as a current expense if they are intended to replace the previous stock of timber, but not if they would tend to increase the

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previous potential. Carrying charges could also be deducted as incurred.

Construction

Problems of taxation in the construction field arise because many projects take more than a year to complete, and do not fit easily into the pattern of taxing annual profits.

There are four kinds of contracts: (1) fixed-total-price contracts, where all work is done for a fixed sum; (2) fixed-unit-price contracts, where the price is fixed according to units of work done, such as so much per yard of asphalt laid; (3) cost-plus contracts, where the contractor is entitled to cost plus a fee related to costs; and (4) fixed-fee contracts, where he is entitled to cost plus a fee of fixed amount.

There are two generally accepted methods of accounting for income from construction contracts. One is the "completed contract" method, where no profit is recorded until the contract is finished. The other is the "percentage of completion" method, in which a proportion of the estimated total profit from a contract is taken up periodically according to the work's stage of completion.

In taxing this profit, the Revenue Department uses what has become known as the two-year rule. Its procedure (until recently) was to require the percentage-of-completion method for cost-plus, fixed-fee and fixed-unit-price contracts, and those fixed-total-price contracts lasting at least two years. On fixed-total-price contracts lasting less than two years, the taxpayer could use either the completed contract or the percentage-of-completion method.

However, court judgments have led to the "legal basis" of recording construction profits for tax purposes. Under this system, when a contract

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is in progress at the end of a fiscal period, the income to that date is the difference between the contractor's job costs then incurred, and his progress billings net of holdbacks.

As a result, a contractor now can choose whether to use the so-called "legal basis" or the two-year rule. Often he finds the legal basis more advantageous, since at the mid-point in a contract his costs incurred often exceed his progress billings net of holdbacks.

"Because we would like to see a close correlation between business and taxation concepts of income, we consider the present situation in the construction industry to be unsatisfactory," the Commission said. Some more workable method of reporting profits had to be found.

The Commission said there should be an arbitrary rule prescribing the basis for reporting profits from contracts in progress at a year-end.

Its suggested rule is that all contracts should be reported on a percentage-of-completion basis except that, in the case of fixed-total-price contracts, such reporting would not be required until direct costs have exceeded 35 per cent of the contract price excluding extras.

The percentage-of-completion formula would be based on the proportion of total costs to date to total estimated costs, and would provide for reasonable adjustments in estimated costs based on known factors. The formula also would provide for full deduction of any estimated losses on fixed-total-price contracts as soon as direct costs exceeded 35 per cent of the contract price.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 24

STABILIZATION POLICIES

OTTAWA — Faster, more effective federal actions to prevent or check inflations and recessions were urged today by the Royal Commission on Taxation.

To ensure that Ottawa can and will carry out its vital task of economic stabilization better than it has done in the past, the Commission recommended these new duties and powers for the federal government:

1. When either the unemployment rate or price increases exceed the limits set in agreed economic goals, a full-scale debate in the House of Commons should be mandatory. The government should be required to state what it is doing or intends to do about the situation. The object is to prevent government procrastination and to encourage early and decisive action.

2. Under similar economic circumstances, the government should have standby authority to act quickly by changing specific taxes within specified limits. These tax changes would be subject to later parliamentary approval. Here, the object is to get more flexibility than is possible by using only an annual budget to make changes.

But which tax rates should normally be changed?

Across-the-board changes in personal income tax rates or credits "are beyond question the most effective single tool for discretionary stabilization policy," the Commission said.

Such tax changes can have real economic bite: the response to them in terms of changing the overall level of demand for goods and services tends to be relatively fast and widespread.

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For this and other reasons the Commission recommended:

"...the federal government should maintain its present share of the personal income tax. Further increases in the provincial abatement should be strongly resisted."

However, this should not be taken as a recommendation about the extent to which the federal government should make tax room available to the provinces, the Commission said. This question was outside the Commission's terms of reference.

"What we do recommend is that, if it is federal government policy to make additional tax room available to the provinces, some method other than larger abatements of federal personal income taxes should be found for doing so, at least until satisfactory alternative devices have been developed."

Given appropriate federal stabilization policies, the question then arises as to whether their intended impact on the economy might be offset by the expenditure and taxation policies of the provincial and municipal governments.

Contrary to what many people seem to believe, provincial and municipal spending—although it has been rising relative to federal expenditures in the postwar period—has not been a destabilizing element in the economy, the Commission said. Technically, in fact, it has added to the economy's "built-in stability".

To maintain and perhaps even increase this stability, the Commission made these other major recommendations:

1. Ottawa should make up to the provinces any reductions in their revenues from personal and corporation income taxes and retail sales taxes

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when the actual level of Gross National Product—the total output of goods and services in the whole economy—falls short of potential GNP.

2. To help reduce overall demand under inflationary conditions, the federal government should pay a bonus to the provinces—in the form of a high rate of interest—to induce them to deposit with the federal government the additional revenues from personal and corporation income taxes, and possibly from retail sales taxes, that result from rapid increases in the general level of prices.

The object of this second recommendation is to hold down the rate of increase in provincial government spending under inflationary conditions. When in Ottawa's opinion the inflationary danger had passed, the deposited funds plus the bonus would be released to the provinces.

The Commission emphasized that economic stabilization is the federal government's job—and it should stay that way.

However, the Report added that it would be wise to prepare now for joint federal-provincial stabilization policies in the future, should severe economic stability problems arise, or should the federal share of revenues and expenditures fall sharply.

Two main steps were recommended:

1. The federal government should try to institute a regular and extensive system of continuing federal-provincial consultation on stabilization policies.

2. After experience has been gained, there should be a gradual move from consultation to the development of binding commitments and agreements.

As a starting point, the Commission said, the two levels of government should try to reconcile their future projected revenues and

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expenditures with one another and with forecasts of potential GNP growth. Within this long-run horizon, a mutually acceptable short-run stabilization strategy should be devised.

"It would be naive to expect that, if these steps were followed, governments would be precluded from jockeying for position," the Commission said.

"But if this jockeying takes place well in advance within a context that forces each government to consider the impact of its actions on the nation as a whole, and thus on itself, the possibility of destructive conflict would be minimized."

But even if this mutual strategy can be worked out, the Commission stressed, the federal government should retain the prime responsibility for both the timing and the size of changes made for the purpose of stabilizing the economy.

Although changes in personal income tax rates or credits were regarded by the Commission as the best stabilization weapon in the government's fiscal arsenal, it said others should not be completely ignored.

For example, certain inflationary bottlenecks might be cleared with special taxes on capital investment expenditures, or changes in capital cost allowances.

But making changes in corporation income tax rates or in sales or excise taxes for stabilization purposes, under most circumstances, was discouraged by the Commission.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 25

"REVENUE DRAG"

OTTAWA — A new guide for budget-watchers has been drafted by the Royal Commission on Taxation.

At one time, all eyes were on the government budget itself — whether the government produced a surplus, deficit or balance on its own budgetary accounts.

More recently a new dimension has been added. It's called the "national accounts" budget, a calculation of how all government revenues and expenditures (not only those covered by the budget itself) will affect the economy.

Now, the Commission suggests that the public should be equally concerned about what the government budget does to "revenue drag".

This technical term refers to the tendency for tax revenues to rise faster than incomes when the economy is expanding. Unless this is offset by tax cuts or increased government expenditures, the rate of economic expansion is dragged down. A stationary budget policy in these circumstances can actually stifle the expansion.

Meanwhile, with revenues rising, the government can increase its expenditures at a faster rate than the output of the economy is rising, without having to subject itself to the "discipline" of raising tax rates.

In these circumstances, the Commission feels that a new budget gauge is needed for those who are concerned with the rate of increase in government expenditures.

Accordingly, the Commission has recommended that in each budget the federal government include an estimate of the extent to which its

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individual tax and expenditure proposals are expected to add to or offset the "revenue drag". Along with it should be an analysis of why these changes are necessary in the light of the prevailing economic circumstances.

"If the public can be persuaded to examine the methods by which the government offsets the fiscal drag as closely as changes in the actual surplus or deficit have been examined in the past, responsible government action can be ensured, and the barrier to effective stabilization policy created by the fetish of a balanced budget will be reduced."

Examining the economic effects of federal budgets between 1954 and 1963, the Commission found they were "right only half the time." In three years — 1959, 1960 and 1963 — Ottawa was pursuing restrictive policies when the economic circumstances really dictated an expansionary attitude.

These policy errors had several causes: wrong interpretation of economic circumstances; forecasting errors; inaccurate assessments of the effects of government policy; failure to use other instruments of policy.

But in particular, there seems to have been a lack of awareness of the effects of "revenue drag", the Commission said. Several times over the 10-year period, when strongly expansionary policies were called for, budgets did little more than offset the drag.

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 26

ECONOMIC EFFECTS

OTTAWA — The Royal Commission on Taxation is confident that its proposed reforms would increase Canada's rate of economic growth.

They would also encourage more Canadian ownership of Canadian industry without discriminating against foreign investors or cutting off badly needed capital imports.

These results could be achieved with no reduction in current spending on goods and services, the Report added. And the new system would create no unmanageable balance-of-payments difficulties.

Main economic benefit of the new system would be "an improved allocation of saving."

By this the Commission means, briefly, that the aggregate amount of personal and business saving in Canada—while not substantially affected in terms of volume—would be invested in more productive ways that would bring greater overall returns than at present.

And the higher the returns, the higher the rate of economic expansion, and the faster Canadian incomes will grow.

All of this, of course, would be a long-term process. It would result not from any one recommendation by the Commission, but from the balance of pros and cons of a complex array of separate proposals making up the whole tax-reform package.

The Commission's principal objective was to design a tax system that would be fair—but which would not erode future sources of income simply to redistribute current income. It is satisfied that this goal was met.

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It found that the present system is far from being fair. As for the economic impact:

"What has become apparent to us through our study is that the present tax structure is the result of past crises and revenue requirements and is not a coherent system designed to achieve widely accepted economic and social objectives.

"It would be surprising if the effect of such a system were to correct rather than worsen the allocation of resources achieved through markets. Indeed, we believe that the latter has occurred."

How would this be changed under tax reform?

Briefly, the Commission said the existing tax system grants concessions that are:

1. Inefficient in terms of federal revenue forgone relative to the results achieved (such as the low rate of tax on the first $35,000 of corporation income, which would be wiped out under the proposed reforms);

2. Too generous relative to the possible market bias for which they are supposed to compensate (such as depletion allowances for the mining and petroleum industries, which would also be eliminated under the Commission proposals).

Replacing these inefficient concessions by efficient concessions—not always in the same place—would make it possible to provide more assistance where it is really needed.

Withdrawal of unnecessary concessions would make it possible to reduce taxes where expected before-tax rates of return are higher. This would result in a shift in capital to more productive uses, and hence in greater future output.

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There now is too much investment in some industries and too little in others, the Commission said. This reduces total output.

Such tax distortions would be largely removed by adopting the comprehensive income base, by giving residents full credit for taxes collected from organizations, and by treating losses more liberally.

Under the Commission's proposals, collections of tax at the corporate level would be increased by about 25 per cent. The increases would be due largely to withdrawal of the dual corporation rate, and removal of special industry tax concessions.

Of the overall increase of $532,000,000 in corporation income tax collections—for which resident shareholders would get full credit under the "integrated income" scheme—approximately half or $271,000,000 would be attributable to non-resident investors.

Although this increase would take place only gradually, the cash flow of corporations clearly would be substantially reduced. Unless offset by a reduction in the proportion of corporate earnings distributed in cash, the tax increase probably would result in a reduction in corporate retained earnings, a major source of business savings.

The Commission does not anticipate that cash dividends would decline absolutely, except possibly for a few large mining and petroleum corporations, but it does expect that under the proposed tax system most resident-owned corporations not now enjoying special tax concessions would be able to increase the proportion of their earnings retained by holding their cash dividends to current levels as their earnings grew. This would not hurt the cash position of low and middle income resident shareholders because they would benefit from integration. It would be in the interest

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of these shareholders that such corporations increase their capital expenditures more rapidly and increased retentions would be the cheapest method of financing that expansion.

The Commission concludes that, on balance, the rate of business saving is unlikely to change. The increased retentions of most corporations would offset the reduced retentions of those corporations that would have their special concessions removed.

Personal saving would, however, likely decline.

A large part of the tax increases for those with high incomes likely would be financed through reduced personal saving. A large part of the tax reductions for those with low incomes likely would be spent. There also would be reduced corporation cash dividends, and this also would reduce personal saving.

All told, the Commission estimated that personal saving in Canada would decline by some $135,000,000. But this is less than four per cent of all personal saving. The main change would be in the direction of this saving—more of it would be shifted into the purchase of stocks, and less into the purchase of fixed-income assets (including bonds).

This decline, in turn, would be more than offset by an increase in government saving. The proposed new tax system would raise, on full implementation, about $200,000,000 more than the existing system on the basis of 1964 tax returns.

Thus, with no change in business saving, and no change in Canada's reliance on foreign saving, the Commission said it expects that the volume of saving and investment in Canada would be little changed by adopting the proposed tax system.

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"If the tax changes had any net impact they would probably increase the propensity to invest relative to the propensity to save, thus stimulating the economy," the Report said.

Meanwhile, the nature of capital flows into Canada from abroad probably would be changed substantially.

Although foreign direct investment in Canada would be unlikely to decline—except in the mining and petroleum industries—Canadians' foreign direct and portfolio investment would likely be reduced, as Canadian investment became more attractive.

Canadians likely would sell their portfolio holdings in foreign corporations to non-residents. Non-residents would tend to sell their Canadian portfolio holdings to Canadians.

Lower Canadian bond prices brought about by the shift in demand from bonds to shares by Canadians would induce non-residents to invest more heavily in bonds as the yield rose. And this would tend to increase the net capital inflow, unless the Bank of Canada moved to offset it through changes in monetary policy.

In summary, the Report said:

"We believe the adoption of our proposals would not affect the rate of investment but would greatly improve the allocation of capital. This would increase the rate of growth over a long period without forcing Canadians to consume less or rely more heavily on foreign saving."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 27

FOREIGN INVESTMENT

OTTAWA — The Royal Commission on Taxation is confident that its "integration" proposals would boost Canadian ownership of Canadian resources without driving out American and other non-resident direct investment.

The Commission said today in its Report to the government that it is opposed to anything that would create the impression that Canada is hostile to foreign investment. But on the otner hand it wants foreign subsidiaries in Canada to become more conscious of the Canadian public interest.

It has therefore recommended:

—Abandonment of the provisions under which a foreign-controlled Canadian corporation offering Canadians at least 25 per cent ownership qualifies for a lower rate of withholding tax on dividends paid to its non-resident shareholders. The integration proposal would act as a positive incentive to achieve the same goal.

—Steps by both the federal and provincial governments to force full public disclosure of all necessary information on the financial position of all substantial corporations in Canada, regardless of whether they are controlled in Canada or abroad.

Canadians entering the debate about foreign investment—with all its economic, social and political aspects—should be aware that foreign investment confers a large net economic benefit on Canada, the Commission said.

"If Canada were to reduce the inflow of foreign capital (we are not speaking here of the need to regulate the inflow for stabilization

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purposes), we are convinced that, from an economic point of view, Canadians would be less well off. This does not mean that Canada should not strive to increase the net economic benefit; nor does it mean that Canadians are not at liberty to forgo a net economic benefit in order to achieve more fully some other objective. It does mean that there is a cost to reducing foreign investment and that this cost should be borne in mind in reaching a decision."

The Commission recognizes the possibility that this benefit might be increased by changing the form of foreign investment in Canada. In particular, it acknowledges that substituting foreign portfolio investment for foreign direct investment could increase Canada's net economic benefit from foreign investment. It emphasizes, however, that this would hold true only if several important conditions were met.

The effects of U.S. retaliation as the result of Canadian tax changes were considered by the Commission.

"Part of the net benefit from foreign investment in Canada is the revenue obtained from taxing the Canadian income of non-residents. Canada has been able to raise substantial revenue from taxing such income because the United States government gives its corporate residents credit for foreign taxes paid up to the amount of their United States tax liabilities.

"It is of vital importance that Canada avoid taking actions that would lead the United States and other foreign governments to reduce their foreign tax credits, for this would force Canada to reduce its tax revenue from this source if it wanted to maintain the capital inflow."

The Commission tried to put the independence issue into some perspective.

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"The United States government can and probably does influence the behaviour of the Canadian subsidiaries of United States parent companies. When the policies or interests of the governments of Canada and the United States are in conflict it seems to us inevitable that these Canadian companies will sometimes act in a manner that is inconsistent with the Canadian public interest. This understandably annoys and frightens Canadians.

"What is often overlooked, however, is the fact that, because there is a high degree of economic interdependence between nations, and because of its greater relative economic power, the United States government could exert great economic influence on Canada even if there were no United States foreign subsidiaries here.

"Reducing United States foreign direct investment in Canada would not necessarily make Canada more independent; and it could make Canadians poorer.

"Furthermore, just as Canadian actions are constrained by United States policies, so are the actions of the United States constrained by the policies of Canada and other nations, as their balance-of-payments problem attests."

The Commission added:

"Even if there were less foreign ownership and control of Canadian business and resources, it is not obvious that Canadians would be appreciably less at the mercy of United States economic policies. The United States government could resort to other instruments to achieve many, if not all, of the same purposes."

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Reducing foreign investment and control would, however, "force the United States administration to take overt action. Overt actions that are not in the Canadian interest might be difficult to push through the United States Congress, but this, of course, depends on the mood of the Congress."

The Comission is sceptical that foreign ownership of Canadian subsidiaries is the primary cause of inefficient economic behaviour.

"The major problem is not foreign control as such but the absence of effective competition. This results from Canada's tariff structure and the monopolistic character of United States industry," according to the Commission.

The Commission does not claim that the adoption of its tax proposals would have a dramatic effect on foreign ownership and control.

"It is our view that the present tax system discriminates against equity investment by Canadians, and we are convinced that the implementation of our reforms, particularly the full integration of corporate and personal income taxes for resident shareholders, would reduce the cost of equity capital in Canada.

"Because our proposals would not make foreign direct investment in Canada less attractive to non-residents, but would provide an inducement to foreign-controlled companies to sell shares in Canada, we think our reforms would increase Canada's net economic benefit from foreign investment.

"How great an impact our proposals would have in this respect is impossible to say, but we are satisfied that the change would be in the right direction."

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The Commission is convinced that adoption of its proposed integration system would be as effective as the different rate of withholding tax and would do the job in a "more acceptable way".

Under this proposal, Canadian shareholders would take into their income the full before-tax value of their share of corporate income. But since tax would already have been collected from corporations on this income at the flat rate of 50 per cent, Canadian shareholders would get a full tax credit for this tax already paid on their behalf.

Thus, the corporation tax would no longer be a separate tax levy. The treatment of non-resident shareholders would remain unchanged; withholding tax would still be levied on dividends.

The Commission believes that this proposal, coupled with its recommendations for more generous tax treatment of business and property losses, with the proposals concerning Registered Retirement Income Plans, and with the special new inventives for new and small ventures, would encourage Canadian ownership of Canadian equities. Some of these gains would be offset by the proposed taxation of capital gains realized from the sale of shares, but the Commission believes that the net effect would be positive.

If all these proposals were implemented, the Commission envisaged this probable course of events:

Because of the full tax credit for corporation income taxes, Canadian equity investments would have a higher return to residents than to non-residents. Canadians would find investing in Canadian shares more attractive.

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Share prices would likely rise due to this increased demand for Canadian shares by Canadians. After this price increase the after-tax rate of return to non-residents on Canadian shares would be reduced relative to the after-tax rate of return on non-Canadian shares. Over time, non-residents could be expected to sell some of their Canadian shares to Canadians. But this repatriation likely wouldn't occur fast enough to hold down the prices of Canadian shares.

The higher price for Canadian shares would make it cheaper for Canadian corporations to raise capital and, because the ultimate tax for residents on interest and dividends would be the same, the corporations would be more likely than at present to sell shares rather than bonds. Therefore, some increase in the supply of Canadian equities could be expected.

Similarly, foreign-controlled corporations in Canada would be encouraged to issue shares in Canada and foreign direct investment would likely decline. The Comission noted it is difficult to estimate the impact of this encouragement, because if the parent company abroad didn't need additional capital it would be indifferent to the attractive price obtainable on the sale of shares in Canada.

The Commission concluded:

"Rather than attempting to drive foreign direct investment out of Canada, we recommend a tax system that would encourage Canadian equity investment by Canadian residents. If our reforms have the impact we expect, Canadians would pre-empt more of the opportunities for profitable investment in Canada that have been attracting the equity capital of non-residents.

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This would be a by-product of the tax system we propose for essentially domestic reasons; but it would be a valuable by-product."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 28

INTERNATIONAL COMPETITIVE POSITION

OTTAWA — The Royal Commission on Taxation is firmly opposed to tax incentives designed to stimulate Canadian exports.

It recommended today that the federal government avoid tampering with the tax system for such a purpose, and do its best to get such export subsidies eliminated in other countries.

These conclusions flowed from the Commission's study of whether taxes have damaged the ability of Canadian companies to compete with foreign goods and services in markets abroad and at home.

Its answer in brief: a qualified "no".

In the early 1960's many people were blaming the tax system for a decline in Canada's international competitive position.

But subsequently it was argued that the real villain was an over-valued Canadian dollar, and that taxes had little if anything to do with the deterioration.

"We are in complete agreement with this diagnosis," the Report said.

The Commission agreed that the tax structure—as opposed to the actual level of taxes—can possibly reduce effort, initiative, risk taking, investment and technical progress. This would lower the rate of productivity advance, and the country's competitive position could thereby suffer.

However, the Commission said it believes that by reforming the tax system, Canada can improve the allocation of its resources and increase its productivity. "Our detailed proposals are designed to achieve these

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results while improving the fairness of the system," the Commissioners noted.

As for the actual level of taxes, the Commission said that with one exception—taxes on corporate income—it found no evidence that Canadian taxes were too high or were increasing more rapidly than taxes in other developed countries.

The effective rate of Canadian corporation income taxes in 1951 was lower than in the United States. But by 1964 the Canadian rate had increased slightly, while in the meantime the effective United States rate was falling dramatically, due largely to generous depreciation rules and investment allowances. As of 1964 the effective rates of tax on corporate income in the two countries were about the same.

Any adverse effect on Canada's competitive position as a result of these changes has been completely swamped by the benefits of dollar devaluation, the Commission said.

However, the Commission was concerned about the relatively heavy weight that Canada now places on corporation income tax revenues as a proportion of total tax revenues.

This heavy tax weight on Canadian corporate source income reduces the after-tax rates of return to Canadians on Canadian equities, reduces the rate of domestic capital formation, and distorts the allocation of capital in Canada, the Commission said.

These adverse effects would be overcome by the Commission's proposal to "integrate" personal and corporation income taxes for Canadian shareholders, the Report noted.

Some people argued before the Commission that the federal sales

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tax, now applied at the manufacturing level, discriminated in favour of importers. Any such adverse effects on Canada's competitive position—if in fact they exist—should be removed by the recommendation that sales taxes be imposed at the retail level and that producer goods be exempted, the Commission said.

The Commission also heard arguments that exporters in other countries get special tax relief, giving them a competitive advantage over Canadian exporters.

Such tax incentives do in fact exist, the Commission found. But it added:

"None seem to be of great significance, some of them are in the process of being dismantled, and the continuation or expansion of others would be a violation of the letter or spirit of international agreements."

While such tax incentives do not constitute a major or increasing problem, Canada should work for their elimination, the Commission said.

It added that Canada should avoid such export subsidies through the tax system—not only because of international agreements against them, but because they are bound to create unfairness in the treatment of different taxpayers, and "can be presumed to result in a misallocation of resources, permanent reductions in output, and possibly a lower growth rate."

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 29

EDUCATION

OTTAWA — More equitable and more effective tax provisions to encourage university and other post-secondary education were recommended today by the Royal Commission on Taxation.

In effect, the present deductions for the costs of such education would be abandoned. Replacing them should be a system of transferable tax credits that would be of greater value to low income parents and students. Allowance should be made for fees and also, in some circumstances, students' living costs away from home.

The new system for education would be part of the overall proposed tax reform under which families would be taxed on their aggregate income, children would be regarded as dependants up to age 21, and gifts from one family member to another would have no tax consequences.

Given this system, the educational provisions would work this way:

—A full-time student over 21 but under 25 could elect, jointly with his parents, to continue as a member of the family tax unit. This means he would not be taxed, as he would be otherwise under the proposed new tax system, on his parents' contributions to his education. And his parents could continue claiming him as a dependant.

—A tax credit equal to 25 per cent of the fees paid by or on behalf of the student for post-secondary education should be provided. The credit would apply to the tax unit of which the person paying the fees was a member. For lower income tax units, the tax credit would be more valuable than a deduction.

—A further annual tax credit of $300 should be provided for a full-time student in recognition of his living expenses, if the student is

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not a dependent child. If the parents already are claiming the student as a dependant, this tax credit should not be available to the family tax unit.

—Unclaimed tax credits should be carried forward to be used to reduce tax liabilities at any time.

The Commission emphasized that it is more concerned with the method than with the amounts.

Main objective of the Commission was to encourage more Canadians to improve their education. It noted that the proportion of Canadians proceeding to university still lags far behind the proportion in the United States, despite massive increases in government expenditures on post-secondary education in recent years.

This education gap could be narrowed or closed in a number of ways:

Universities could be given increased grants so they could reduce their fees, and more students could be provided with more generous bursaries to meet their living costs.

Loans and grants to students could be provided to make it possible for more of them to buy the higher education they want.

Tax concessions could be provided to make it easier for parents to finance the education of their children, or students to finance their own education.

"We have not attempted to evaluate which technique or combination of techniques would be preferable," the Report said. "To have done so would have taken us far beyond our terms of reference."

"Our predilection is for increased government expenditure; but we thought it would be unwise for us to assume that government grants would

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increase so rapidly that other assistance would not be necessary.

"We therefore have made recommendations that we believe would encourage post-secondary education more equitably and effectively than the present tax provisions. By putting forth these recommendations we do not wish to imply that the tax concessions technique is the best technique, or that the proportions or dollar limits we suggest are in any sense firm recommendations.

"We are primarily interested in the method rather than the amounts. The amounts should be determined in the light of the objectives and the expenditure decisions that are taken."

The Commission noted that by allowing unused education credits to be carried forward indefinitely, and by allowing the credit to be transferred between tax units, the proposed tax system would allow students with no current income to borrow to finance their education with the knowledge that they could more easily repay the loan, because their tax liabilities in the first years after graduation would be reduced by the educational credits.

This is shown in the following example:

Under the present system, students taking higher education or training are entitled to deduct tuition payments in excess of $25 in computing taxable income.

Assuming that the average student is unmarried, pays tuition fees of $400, and has part-time earnings of $2,000, his annual tax liability under the existing system, including old age security tax, is $64.

Under the Commission's proposals, if the student was not a member of his parents' tax unit and had the same expenses and earnings, his annual tax credit would be $400, of which only $128 would be offset against

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taxes otherwise payable.

Over a five-year period the student would accumulate a total credit of $1,360 that could be carried forward indefinitely.

Assuming this student married on graduation and had an average income in the years immediately following of $6,000, the student would pay no tax for two years. This would make it much easier to repay any loans contracted while he was a student.

ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 30

MINORITY REPORT — GRANT

OTTAWA — A modified proposal for the taxation of capital gains has been submitted by Donald G. Grant of Halifax in his Minority Report as a member of the Royal Commission on Taxation.

Mr. Grant said the Commission's majority recommendation for the full taxation of all capital gains is too stringent, and he said it might inhibit investment in Canada by Canadians.

His own recommendation is that some kinds of capital gains should be taxed at full rates, and other kinds at preferential rates, depending on the nature of the transaction and the time-span over which the gain was realized.

Mr. Grant also differed with certain aspects of the Report in its recommendations concerning treatment of business losses for tax purposes, gift exemptions, the amount of pension contributions that would be deductible, and the proposal to eliminate the special $500 deduction now provided for those aged 70 or over.

In his preface to a brief six-page Minority Report, Mr. Grant, President of the Nova Scotia Trust Company, said his dissent from a few of the Report's recommendations "is due principally to my inability to accept in its entirety the concept of income as contemplated by the comprehensive tax base and the wisdom of applying this concept to the tax system at this time."

The Report contends that the taxation at progressive rates of tax of all additions to economic power—that is, the power to consume goods and services—is the only equitable basis for taxation.

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"Complete adoption of this principle in my opinion would destroy certain elements of our present system which should be retained," Mr. Grant said.

Referring to taxation of capital gains, he said the Report seeks to minimize the inequities that would result from this proposal by providing some ameliorating provisions.

Notable among these would be the lowering of the top individual tax rate, income averaging, full integration of corporation and individual tax rates, and deduction of capital losses from all forms of income.

"These provisions, in my opinion, prove inadequate as compensatory measures to ease what must be regarded as stringent legislation."

There also are other reasons why capital gains should not be taxed at full rates, Mr. Grant said. Canadian investment should be encouraged. It should also be remembered that Canada's two principal trading partners, the United States and Britain, tax capital gains at modified rates.

"The inflationary element is ever present in gains in securities and real estate, and to tax capital gains that resulted from a general increase in price levels at full rates would be inequitable," he added.

Following is Mr. Grant's alternative:

All property gains realized within one year from the date of acquiring the property, and real estate gains realized within three years of acquisition, would be taxed at full rates.

To this would be added a provision that land which has been expropriated within the three-year period would be exempt from capital gains tax if the owner acquired it without prior knowledge of expropriation,

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and did not attempt to dispose of it prior to the expropriation, and if the proceeds from expropriation were re-invested in a similar way within a stated period of time.

After the one- and three-year periods, capital gains would be taxed in the hands of the individual at one-half his marginal rate of tax (and therefore would not exceed 25 per cent) and in the hands of corporations at half the corporate rate, or 25 per cent.

Losses would be deducted against capital gains in the year incurred, with a loss carry-back for one year and a carry-forward indefinitely against capital gains.

Mr. Grant also disagreed with his fellow Commissioners—as did Emile Beauvais of Quebec City—in their recommendation that unrealized capital gains should be deemed to have been realized (and thus be taxable) on the break-up of the family unit or on the death of the surviving spouse.

"In my opinion the latent hardships involved in such a policy, including forced sale of assets and double taxation on distribution, are far greater than any inconvenience to the Revenue which will collect its tax eventually," Mr. Grant said.

He said there should be no taxation without realization, unless a taxpayer leaves Canada.

Concerning the proposed withdrawal of the special $500 deduction from taxable income for those over 70, Mr. Grant said it should be retained "until suitable adjustments are made through transfer payments."

He also favours a $1,000 exemption, instead of the $250 proposed in the majority **Report**, on the annual value of gifts received by an individual from outside the family tax unit.

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The Report would limit deductible contributions to a Registered Retirement Income Plan to the provision of a benefit equivalent to an annual payment on retirement of $12,000.

"To restrict the purchase of savings to this figure would mean a cutback in some of the Registered Retirement Income Plans now in existance, in both current and past service, and would fail to meet pension requirements for many in business and the professions where creative capacity must be recognized," Mr. Grant said.

He said he would prefer to retain the present system (under which contributions are deductible up to $1,500 a year) or—if policing this is impossible—he would raise the limit at retirement to $20,000, with a provision for past-service pensions.

In its discussion of business losses, the Report recommended that business be permitted to apply them against income from all sources over a period of two years preceding a year of loss and indefinitely thereafter. However, this would be restricted by an arbitrary rule to the effect that if three years' losses are sustained in a business over a five-year period, then subsequent losses would be deductible only from income of the same business and not from income from other sources.

Mr. Grant opposed this latter restriction. He commented:

"I support the view that no person wishes to conduct a business at a loss. If this is not always true, then the great majority of such business undertakings should not be placed under arbitrary restrictions to block abuses of a relative few.

"Such a provision could dislocate established businesses, as in some cases it would cause an involuntary and premature closing with

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resultant unemployment. In addition—and this would perhaps be a more serious consequence—it would have a deterrent effect on the establishment of new businesses. To follow the Report in this instance would inhibit expansion and curtail initiative."

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ROYAL COMMISSION ON TAXATION

PRESS RELEASE No. 31

MINORITY REPORT — COMMISSIONER BEAUVAIS

OTTAWA — In a Minority Report, A. Emile Beauvais of Quebec City has disagreed with fellow members of the Royal Commission on Taxation on some fundamental principles and certain of the key recommendations.

Commissioner Beauvais has in particular opposed the majority recommendations for a comprehensive tax base, taxation of capital gains at full progressive rates, and integration of personal and corporation taxes.

He views the latter proposal—that is, giving resident shareholders full credit for taxes collected from Canadian corporations—as possibly a windfall to present high income shareholders.

"I acknowledge the fact that it would greatly simplify the taxation system if such a recommendation were adopted, but I cannot reconcile myself to the idea of wealthy people receiving such a windfall in cases where no special transition tax was paid or in cases where such a tax would be paid when the transitional period has ended."

Mr. Beauvais, a former Governor of the Canadian Tax Foundation, calls for serious consideration of an alternative method—the proposal made by the so-called Committee of Four, a group appointed by the Minister of Finance in 1960 to advise on problems connected with corporate taxation.

This Committee-of-Four proposal would mean that corporations would be taxed as they are now, but in addition all actual or deemed distributions of dividends would be subject to a 15 per cent tax. No further tax would be imposed on shareholders, and refunds would be allowed to low income shareholders. The existing 20 per cent dividend tax credit would, of course, be abolished.

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Mr. Beauvais included in his Minority Report several detailed tables to show how corporations and their shareholders in various situations would be affected by the present tax system, the main Report's recommendations, and implementation of the Committee-of-Four proposals. The tables also show how Government revenues would be affected.

He noted that under the Committee-of-Four proposals, as modified in submissions to the Royal Commission by both the Canadian Bar Association and the Canadian Institute of Chartered Accountants, it would appear that income taxes paid by the corporation would be higher.

However, Mr. Beauvais pointed out that the 15 per cent withholding tax would in fact be paid by reducing the amount paid or allocated to the shareholder, so that the corporation's cash flow would not be reduced.

"It is true that the shareholder will receive less cash, but having no further tax to pay he will be better off," Mr. Beauvais said.

The Commissioner observed that the main Report suggested that the income-integration proposal would make holding Canadian equities more attractive to low and middle income resident individuals, and less attractive to upper income individuals.

"I cannot agree with this reasoning," said Mr. Beauvais, "because it seems to me that funds from sales of Canadian equities are certainly more likely to be obtained from upper income resident individuals than from lower income resident individuals."

Referring to the proposed comprehensive tax base, he said he could not agree that it should be defined to include all additions to the taxpayer's economic power, including so-called capital gains.

Mr. Beauvais said he is not opposed to a tax on capital gains,

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but thinks it should be limited to gains from the sale of certain assets specified in a list—primarily securities and real estate which were held for a certain length of time.

He said the tax on such gains should be based on the measures now applied by the United States Internal Revenue Code, so that an amount equivalent to half the gain would be taxable at progressive rates—but with a maximum rate of 50 per cent.

In most countries, capital gains are taxed at special rates.

"If my information is correct, Canada would be the only country in the western world to tax so-called capital gains at full progressive rates, and, what is more serious, to tax these gains on a deemed realization basis at death."

Mr. Beauvais was especially opposed to the latter recommendation of the majority Report. He said capital gains should be taxed only when they are realized, although he would make an exception in the case of a taxpayer leaving the country.

Inheritances should be considered as gifts, and taxed as capital gains by the method described above, he said.

Other points on which Mr. Beauvais differed with the main Report:

— Withdrawal of the existing $500 deduction from other income allowed to those aged 70 or over. He said this provision should not be repealed until an equivalent transfer payment is made by the government.

— The recommendation that a person provided with room and board in the home of a close relative should take into his taxable income a deemed gift of $1,000 less any amount he contributed toward the cost of room and board. Mr. Beauvais regards this as "anti-social."

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— The proposed annual gift exemptions of $250 for an individual and—in the case of families—$250 for each spouse and $100 for each dependent child. Mr. Beauvais said these are not high enough. He said there should be a $1,000 annual exemption on gifts to close relatives outside the family tax unit, and $500 a year on all other gifts. He would also provide a $10,000 exemption on wedding gifts.

— The proposal that all gifts worth more than $100 to persons outside the family tax unit must be reported to the tax authorities. Mr. Beauvais said this is too low. He suggested that only gifts over $1,000 should have to be reported, as now is the case.

— The specific dollar limits suggested in the main Report for allowable travelling and entertainment expenses. He said he is against stating these arbitrary limits. The amounts allowed should depend on the circumstances—such as the position of the employee, the importance of the trip, the place visited, and so on.

— Employers who fail to allocate to employees the value of non-cash benefits provided to these employees would be required to pay a special tax equal to the value of the benefits. He said employers should not be penalized when they incur such an expense of doing business.

— The proposal that the value of such benefits as free or low cost meals, free or low rent housing, or schooling for their children should be included in the income of the employees involved. Mr. Beauvais said it is imperative that in certain regions industries provide such benefits in order to attract the employees they need.

— The recommendation that the income of dependent children be aggregated with family income and that an exemption of $500 of earned

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income be allowed for each dependant. Mr. Beauvais said he would prefer to see the present $950 exemption maintained; if a child earned more, then the parents should not be entitled to the tax credit for the child, his income should not be added to the family income, and he would pay his own income tax.

— The proposal that a child receiving a gift from outside the family tax unit could deposit the money in an Income Adjustment Account. The Commissioner observed that if it was a non-cash benefit, the child's parents might have to borrow to pay the tax on its value or make the deposit in the special account. As an alternative, he suggested that the person making the gift should be allowed to pay the tax himself.

— Inclusion of life insurance policy dividends in the income of the recipient. Mr. Beauvais said he is not opposed to the general recommendation that this be done. But he said it should apply only to dividends on policies issued after the effective date of the legislation. Otherwise this provision would be "equivalent to a kind of retroactive legislation."

— The proposed limitations on deductions from other income for contributions to Registered Retirement Income Plans. The main Report said these contributions should be deductible only up to the point of acquiring a retirement benefit equal to a $12,000 annuity payable at age 65 with a 10-year guarantee. Mr. Beauvais said this is not enough: "it is imperative in the hiring of executives of high quality to offer retirement savings plans of more than $12,000 a year." He said a limit of from $25,000 to $30,000 should be recommended.

— The Commissioner also objects to the proposed taxation of

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mortality gains from life insurance, and bringing the proceeds of life insurance policies into the tax base at death.

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